

# Advocate Aurora Health, Inc.

Condensed Consolidated Financial Statements and Other Information  
As of and for the Three and Nine Months Ended September 30, 2020



Document Dated as of November 23, 2020

**ADVOCATE AURORA HEALTH, INC.**  
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**ADVOCATE AURORA HEALTH, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in thousands)

	Unaudited	Note 1
	September 30, 2020	December 31, 2019
Assets		
Current assets		
Cash and cash equivalents	\$ 1,248,305	\$ 449,712
Assets limited as to use	110,099	106,529
Patient accounts receivable	1,487,883	1,605,607
Other current assets	679,880	619,542
Third-party payors receivables	39,507	15,331
Collateral proceeds under securities lending program	16,971	18,284
Total current assets	3,582,645	2,815,005
Assets limited as to use	9,773,532	9,140,565
Property and equipment, net	5,774,845	5,901,923
Other assets		
Intangible assets and goodwill, net	74,087	76,830
Investments in unconsolidated entities	197,144	212,415
Reinsurance receivable	48,376	52,312
Operating lease right-of-use assets	321,858	352,295
Other noncurrent assets	413,047	382,024
Total other assets	1,054,512	1,075,876
Total assets	\$ 20,185,534	\$ 18,933,369

(Continued)

**ADVOCATE AURORA HEALTH, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in thousands)

	Unaudited	Note 1
	September 30, 2020	December 31, 2019
Current liabilities		
Current portion of long-term debt and commercial paper	\$ 101,286	\$ 184,098
Long-term debt subject to short-term financing arrangements	119,660	147,535
Current portion of operating lease liabilities	78,359	77,957
Accounts payable and accrued liabilities	2,003,473	1,863,035
Third-party payors payables	1,097,677	303,300
Current portion of accrued insurance and claim costs	116,083	114,741
Collateral under securities lending program	16,971	18,284
Total current liabilities	3,533,509	2,708,950
Noncurrent liabilities		
Long-term debt, less current portion	3,320,437	2,729,366
Operating lease liabilities	281,389	314,106
Accrued insurance and claims cost, less current portion	591,130	544,839
Accrued losses subject to insurance recovery	48,376	52,312
Obligations under swap agreements	124,388	91,340
Other noncurrent liabilities	927,647	793,792
Total noncurrent liabilities	5,293,367	4,525,755
Total liabilities	8,826,876	7,234,705
Net assets		
Without donor restrictions		
Controlling interest	10,986,970	11,309,819
Noncontrolling interest in subsidiaries	148,044	146,740
Total net assets without donor restrictions	11,135,014	11,456,559
With donor restrictions	223,644	242,105
Total net assets	11,358,658	11,698,664
Total liabilities and net assets	\$ 20,185,534	\$ 18,933,369

*Note 1: December 31, 2019 financial statement information was derived from and should be read in conjunction with the Advocate Aurora Health, Inc. consolidated audited financial statements as of and for the year ended December 31, 2019, available on the Electronic Municipal Market Access website ([www.emma.msrb.org](http://www.emma.msrb.org))*

See accompanying notes to condensed consolidated financial statements.

**ADVOCATE AURORA HEALTH, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS**  
**(in thousands)**

	Unaudited		Unaudited		Note 1
	Three Months Ended September 30, 2020	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019	Year Ended December 31, 2019
Revenue					
Patient service revenue	\$ 2,656,603	\$ 2,659,294	\$ 7,320,423	\$ 7,859,370	\$10,660,969
Capitation revenue	287,302	316,409	846,221	952,891	1,264,162
Other revenue	508,467	235,285	1,301,404	629,534	880,292
Total revenue	3,452,372	3,210,988	9,468,048	9,441,795	12,805,423
Expenses					
Salaries, wages and benefits	1,805,358	1,754,081	5,497,991	5,155,253	6,988,562
Supplies, purchased services and other	1,052,443	1,020,401	3,019,669	2,940,152	3,999,005
Contracted medical services	130,545	152,384	396,792	416,676	543,716
Depreciation and amortization	138,745	137,422	419,955	413,773	569,956
Interest	29,459	27,224	83,878	81,808	106,314
Total expenses	3,156,550	3,091,512	9,418,285	9,007,662	12,207,553
Operating income before nonrecurring expenses	295,822	119,476	49,763	434,133	597,870
Nonrecurring expenses	20,060	38,238	76,689	107,781	116,800
Operating income (loss)	275,762	81,238	(26,926)	326,352	481,070
Nonoperating income (loss)					
Investment income (loss), net	335,550	13,742	(191,082)	712,768	1,053,898
Loss on debt refinancing	—	—	(12,244)	—	(21,665)
Change in fair value of interest rate swaps	3,587	(13,650)	(33,048)	(34,298)	(21,079)
Pension settlement loss	(119,658)	—	(119,658)	—	—
Other nonoperating income (loss), net	1,772	(17,703)	(22,664)	86,524	54,473
Total nonoperating income (loss), net	221,251	(17,611)	(378,696)	764,994	1,065,627
Revenue in excess of (less than) expenses	497,013	63,627	(405,622)	1,091,346	1,546,697
Less noncontrolling interest	(17,473)	(14,533)	(29,278)	(41,284)	(60,749)
Revenue in excess of (less than) expenses - attributable to controlling interest	\$ 479,540	\$ 49,094	\$ (434,900)	\$ 1,050,062	\$ 1,485,948

(Continued)

**ADVOCATE AURORA HEALTH, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS**  
(in thousands)

	Unaudited		Unaudited		Note 1
	Three Months Ended September 30, 2020	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019	Year Ended December 31, 2019
<b>Net assets without donor restrictions, controlling interest</b>					
Revenue in excess of (less than) expenses - attributable to controlling interest	\$ 479,540	\$ 49,094	\$ (434,900)	\$ 1,050,062	\$ 1,485,948
Pension-related changes other than net periodic pension costs	101,829	1,657	107,115	115,838	(106,221)
Net assets released from restrictions for purchase of property and equipment	1,388	1,940	4,529	3,685	4,839
Other, net	242	(25)	407	1,035	1,108
Increase (decrease) in net assets without donor restrictions, controlling interest	582,999	52,666	(322,849)	1,170,620	1,385,674
<b>Net assets without donor restrictions, noncontrolling interest</b>					
Revenues in excess of expenses	17,473	14,533	29,278	41,284	60,749
Distributions to noncontrolling interest	(5,330)	(8,476)	(27,974)	(23,392)	(32,488)
Other, net	—	11	—	11	11
Increase in net assets without donor restrictions, noncontrolling interest	12,143	6,068	1,304	17,903	28,272
<b>Net assets with donor restrictions</b>					
Contributions	5,608	5,500	16,994	18,999	27,627
Investment income (loss), net	5,598	928	(1,457)	9,882	14,400
Net assets released from restrictions for operations	(3,298)	(5,468)	(10,318)	(13,217)	(18,596)
Net assets released from restrictions for purchase of property and equipment	(1,388)	(1,940)	(4,529)	(3,685)	(4,839)
Central IL net assets with donor restrictions sold	—	—	(18,949)	—	—
Other, net	3,155	(6)	(202)	840	(278)
Increase (decrease) in net assets with donor restrictions	9,675	(986)	(18,461)	12,819	18,314
Increase (decrease) in net assets	604,817	57,748	(340,006)	1,201,342	1,432,260
Net assets at beginning of period	10,753,841	11,409,998	11,698,664	10,242,977	10,242,977
Adoption of ASU 2016-02 (Leases)	—	—	—	23,427	23,427
Net assets at end of period	<u>\$ 11,358,658</u>	<u>\$ 11,467,746</u>	<u>\$ 11,358,658</u>	<u>\$ 11,467,746</u>	<u>\$ 11,698,664</u>

*Note 1: December 31, 2019 financial statement information was derived from and should be read in conjunction with the Advocate Aurora Health, Inc. consolidated audited financial statements as of and for the year ended December 31, 2019, available on the Electronic Municipal Market Access website ([www.emma.msrb.org](http://www.emma.msrb.org))*

See accompanying notes to condensed consolidated financial statements.

**ADVOCATE AURORA HEALTH, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	Unaudited		Unaudited		Note 1
	Three Months Ended September 30, 2020	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019	Year Ended December 31, 2019
Cash flows from operating activities					
Increase (decrease) in net assets	\$ 604,817	\$ 57,748	\$ (340,006)	\$ 1,201,342	\$1,432,260
Adjustments to reconcile change in net assets to net cash provided by operating activities:					
Depreciation, amortization and accretion	138,080	134,086	417,203	408,422	564,270
Amortization of operating lease right-of-use assets	16,458	17,200	49,415	51,429	64,801
Loss on debt refinancing	—	—	12,244	—	21,665
Loss on sale of property and equipment	280	1,675	12,244	2,887	2,618
Change in fair value of swap agreements	(3,587)	13,650	33,048	34,298	21,079
Pension-related changes other than net periodic pension cost	(101,829)	(1,657)	(107,115)	(115,838)	106,221
Net assets released from restrictions for operations	(3,298)	(5,468)	(10,318)	(13,217)	(18,596)
Distribution to noncontrolling interest	8,007	8,476	36,232	28,601	29,446
Distributions from unconsolidated entities	7,571	—	12,068	—	23,707
Gain on Bay Area Medical Center acquisition	—	—	—	(81,736)	(81,736)
Loss on sale of Central IL disposal group	(415)	—	14,585	—	—
Central IL net assets with donor restrictions sold	—	—	18,949	—	—
Changes in operating assets and liabilities					
Trading securities, net	(1,310,327)	(53,120)	(665,327)	(902,446)	(1,433,30)
Accounts receivable, net	(123,857)	71,997	114,728	(96,536)	(103,625)
Accounts payable and accrued liabilities	490,167	272,070	297,334	175,220	203,877
Third-party payors receivable and payable, net	87,143	(20,754)	773,198	20,490	1,640
Other assets and liabilities, net	(63,996)	(150,368)	2,301	(278,319)	(280,549)
Net cash (used in) provided by operating activities	(254,786)	345,535	670,783	434,597	553,773
Cash flows from investing activities					
Capital expenditures	(160,213)	(174,401)	(515,992)	(464,383)	(653,207)
Proceeds from sale of property and equipment	257	1,196	1,903	1,761	4,102
Purchases of investments designated as non-trading, net	(1)	(786)	234	(2,209)	69
Investments in unconsolidated entities, net	(2,500)	1,500	(3,016)	(28,359)	(31,005)
Cash received from sale of Central IL disposal group	190,000	—	190,000	—	—
Investments acquired in Bay Area Medical Center acquisition	—	—	—	34,018	34,018
Other	(2,087)	29,779	(3,773)	8,896	(7,534)
Net cash provided by (used in) investing activities	25,456	(142,712)	(330,644)	(450,276)	(653,557)
Cash flows from financing activities					
Proceeds from issuance of debt	—	—	695,915	56,104	496,074
Repayments of long-term debt	(14,159)	(13,954)	(216,766)	(93,257)	(544,046)
Distribution to noncontrolling interest	(8,007)	(8,476)	(36,232)	(28,601)	(29,446)
Proceeds from restricted contributions and (loss) income on investments	11,206	6,428	15,537	28,881	42,027
Net cash (used in) provided by financing activities	(10,960)	(16,002)	458,454	(36,873)	(35,391)
Net (decrease) increase in cash and cash equivalents	(240,290)	186,821	798,593	(52,552)	(135,175)
Cash and cash equivalents at beginning of period	1,488,595	345,514	449,712	584,887	584,887
Cash and cash equivalents at end of period	\$ 1,248,305	\$ 532,335	\$ 1,248,305	\$ 532,335	\$ 449,712

Supplemental disclosures of noncash information

Operating lease right-of-use assets in exchange for new operating lease liabilities	\$ 5,038	\$ 6,767	\$ 18,719	\$ 418,873	\$ 425,142
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*Note 1: December 31, 2019 financial statement information was derived from and should be read in conjunction with the Advocate Aurora Health, Inc. consolidated audited financial statements as of and for the year ended December 31, 2019, available on the Electronic Municipal Market Access website ([www.emma.msrb.org](http://www.emma.msrb.org)).*

See accompanying notes to condensed consolidated financial statements.



**ADVOCATE AURORA HEALTH, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2020**  
**(in thousands)**

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**1. ORGANIZATION AND BASIS OF PRESENTATION**

**Description of Business**

Advocate Aurora Health, Inc. is a Delaware nonprofit corporation ("the Parent Corporation"). On April 1, 2018, the Parent Corporation became the sole corporate member of Advocate Health Care Network, an Illinois not-for-profit corporation ("Advocate") and Aurora Health Care, Inc., a Wisconsin nonstock not-for-profit corporation ("Aurora"). The Parent Corporation, Advocate, Aurora and their controlled subsidiaries are collectively referred to herein as the "System." The System was formed in furtherance of the parties' common and unifying charitable health care mission to promote and improve the quality and expand the scope and accessibility of affordable health care and health care-related services for the communities they serve.

The System is comprised of various not-for-profit and for-profit entities, the primary activities are the delivery of health care services or the provision of goods and services ancillary thereto.

The System provides a continuum of care through its 26 acute care hospitals, an integrated children's hospital and a psychiatric hospital, primary and specialty physician services, outpatient centers, physician office buildings, pharmacies, rehabilitation and home health and hospice care in northern and central Illinois and eastern Wisconsin.

On April 1, 2019, the System became the sole corporate member of Bay Area Medical Center ("BAMC") through the acquisition of the remaining 51% interest in BAMC and its results have been fully consolidated into the condensed consolidated financial statements of the System as of this date. The acquisition will improve the availability, scope and access to health care in the communities served by BAMC.

**Basis of Presentation**

The accompanying condensed consolidated financial statements as of and for the three and nine months ended September 30, 2020, have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim reporting. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included in these financial statements. Included in the System's accompanying condensed consolidated financial statements are all its controlled subsidiaries. All significant intercompany transactions have been eliminated in consolidation. The accompanying condensed consolidated financial statements do not include all the information and footnotes required by GAAP for complete financial statements. As such the accompanying condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements as of and for the year ended December 31, 2019. The audited consolidated financial statements are available from the Municipal Securities Rulemaking Board ("MSRB") on its Electronic Municipal Market Access ("EMMA") system, found at <http://emma.msrb.org>. Additional information can be found in the investor relations section of the System's website at <https://www.advocateaurorahealth.org/investor-relations>.

Operating results for the three and nine months ended September 30, 2020 are not necessarily indicative of the results that may be experienced during the year ending December 31, 2020.

## 2. SIGNIFICANT EVENTS

Due to the COVID-19, a strain of coronavirus, pandemic, the behavior of businesses and people globally has been altered in a manner that is having negative effects on global and local economies including significant investment market volatility, various temporary business closures resulting in increased unemployment and other effects which could result in supply disruptions and/or decisions to defer medical treatments at the System's facilities.

In March 2020, the System began postponing or canceling elective procedures to comply with public health protocols. The restrictions on elective procedures were not lessened until May 2020. This, along with the growth in the volume of COVID-19 patients, had a negative impact on operations and revenues. The timing, source and rate of reimbursement for COVID-19 related patient care; the ability to respond to patient demand; the extent and timing of federal and state grants; the reimbursements and other contributions to compensate for revenue losses and increased expenses are not fully known at this time. Also unknown are the length of delay and level of attrition in elective procedures, the expense increases and accelerations, the impact of changes in payer mix, the potential increase in the number of uninsured patients, the need for charity care, the effect of the economic downturn on demand for elective procedures and the effect on patient payment extensions.

The potential impact of the COVID-19 pandemic on the System is difficult to predict and could adversely impact the business, investment portfolio, financial condition or results of operations and, accordingly, may materially have an adverse impact on the financial condition of the System. The System is monitoring liquidity and cash flow and has taken, and will continue to take, steps to protect its fiscal health, including a focus on maintaining liquidity to meet its obligations. In addition, the System expects to apply for all appropriate COVID-19 related resources, including supplies, financial support, payroll tax deferrals and relief and other assistance made available through local, state and federal governments.

As of September 30, 2020, the System received \$596,000 in grant payments from the U.S. Department of Health and Human Services ("HHS") from the Provider Relief Fund established under the Coronavirus Aid, Relief and Economic Security Act ("CARES Act"), which has been recognized as revenue and included in other operating revenue within the condensed consolidated statement of operations and changes in net assets. Payments from the Provider Relief Fund are intended to cover patient care lost revenues and qualified expenses, net of other reimbursed sources, attributed to COVID-19 and are not required to be repaid provided the recipient attests to and complies with the terms and conditions of the grant funds. Additional guidance regarding the terms and conditions of the grant funds was issued in October and November of 2020. Management of the System will continue to monitor compliance with the terms and conditions of the CARES Act grant funds and the impact of the pandemic on the System's revenues and expenses. If the System is unable to attest to or comply with current or future terms and conditions, the ability to retain some or all of the distribution received may be impacted.

In addition, the System received approximately \$773,000 from the Centers for Medicare and Medicaid ("CMS") as an advance payment for Medicare services. The funds are provided through the expansion of the Accelerated and Advance Payment Program to ensure providers and suppliers have the resources needed to combat the COVID-19 pandemic. The advances will be recouped by withholding future Medicare fee-for-service payments for claims until such time as the full accelerated payment has been recouped, unless the System elects to repay the advances prior to full recoupment. These advance payments are included in third-party payors payables within the condensed consolidated balance sheets. As of October 1, 2020, the terms and conditions have been revised whereby recoupment has been extended to twenty-nine months after the original receipt of the advance, with recoupments beginning in April 2021. Subsequent to twenty-nine month recoupment period any unpaid remaining balance is subject to an interest charge of 4 percent per annum. The CARES Act also permits employers to defer the employer

portion of Social Security taxes of the FICA tax. Employers are required to remit one-half of the amount deferred by December 31, 2021 and the remaining half by December 31, 2022. Through September 30, 2020 the System has deferred \$153,000 of these taxes, and this liability is included in other noncurrent liabilities within the condensed consolidated balance sheets.

On July 1, 2020, the System sold a majority of the assets and certain liabilities (the "disposal group") related to operations of the System in Central Illinois. The disposal group had assets sold in excess of liabilities transferred of \$205,273 consisting primarily of property and equipment and certain investment interests in unconsolidated entities. The purchase price for the disposal group was \$190,000. The System recorded a loss, net of selling costs, of \$14,585 that is included in nonrecurring expenses in the condensed consolidated financial statements.

### **3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **Use of Estimates**

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates, assumptions and judgments that affect the reported amounts of assets, liabilities and amounts disclosed in the notes to the condensed consolidated financial statements at the date of the condensed consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Although estimates are considered to be fairly stated at the time made, actual results could differ materially from those estimates.

#### **Cash Equivalents**

The System considers all highly liquid investments with a maturity of three months or less when purchased, other than those included in the investment portfolio, to be cash equivalents.

#### **Investments**

The System has designated substantially all of its investments as trading. Investments in debt and equity securities with readily determinable fair values are measured at fair value using quoted market prices or otherwise observable inputs. Investments in private equity limited partnerships and derivative products (hedge funds) are reported at fair value using net asset value as a practical expedient. Commingled funds are carried at fair value based on other observable inputs. Investment income or loss (including realized gains and losses, interest, dividends and unrealized gains and losses) is included in the nonoperating section of the condensed consolidated statements of operations and changes in net assets unless the income or loss is restricted by donor or law or is related to assets designated for self-insurance programs. Investment income (loss) on self-insurance trust funds is reported in other revenue in the accompanying condensed consolidated statements of operations and changes in net assets. Investment income (loss) that is restricted by donor or law is reported as a change in net assets with donor restrictions.

#### **Assets Limited as to Use**

Assets limited as to use consist of investments set aside by the System for future capital improvements and certain medical education and other health care programs. The System retains control of these investments and may, at its discretion, subsequently use them for other purposes. Additionally, assets limited as to use include investments held by trustees or in trust under debt agreements, self-insurance trusts, assets held in reinsurance trust accounts and donor-restricted funds.

## **Patient Service Revenue and Accounts Receivable**

Patient service revenue is reported at the amount that reflects the consideration to which the System expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including managed care payors and government programs and excludes revenues for services provided to patients under capitated arrangements) and others and include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations. Generally, patients and third-party payors are billed within days after the services are performed or after discharge. Revenue is recognized as performance obligations are satisfied. Provisions for third-party payor settlements and adjustments are estimated in the period the related services are provided and adjusted in future periods as additional information becomes available and final settlements are determined.

As the System's performance obligations relate to contracts with a duration of less than one year, the System has applied the optional exemption provided in the guidance and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

The System does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to the expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payor pays for that service will be one year or less.

The System has entered into payment arrangements with patients that allow for payments over a term in excess of one year. The System has evaluated historical collections in excess of one year and current market interest rates to determine whether a significant financing component exists that would require an adjustment to the promised amount of consideration from patients and third-party payors. The System has determined that the impact of implicit financing arrangements for payment agreements in excess of one year is insignificant to the condensed consolidated statements of operations and changes in net assets.

The System does not incur significant incremental costs in obtaining contracts with patients. Any costs incurred are expensed in the period of occurrence, as the amortization period of any asset that the System would have recognized is one year or less in duration.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is a possibility that recorded estimates will change by a material amount.

## **Inventories**

Inventories, consisting primarily of medical supplies, pharmaceuticals and durable medical equipment, are stated at the lower of cost (first-in, first-out) or market. Retail pharmaceutical inventories are stated at replacement cost.

## **Reinsurance Receivables**

Reinsurance receivables are recognized in a manner consistent with the liabilities relating to the underlying reinsured contracts.

## **Intangible Assets and Goodwill, Net**

Goodwill of \$59,927 and \$62,172 is included in intangible assets and goodwill, net in the accompanying condensed consolidated balance sheets at September 30, 2020 and December 31, 2019, respectively. In 2019, the System elected to amortize goodwill prospectively using the straight-line method over a 10-year period in accordance with Accounting Standards Update ("ASU") 2019-06. Goodwill amortization of \$1,823, \$5,398 and \$6,982 is included in depreciation and amortization in the accompanying condensed consolidated statements of operations and changes in net assets for the three and nine months ended September 30, 2020 and the year ended December 31, 2019, respectively. Intangible assets with expected useful lives are amortized over that period.

## **Asset Impairment**

The System considers whether indicators of impairment are present and, if indicators are present, performs the necessary tests to determine if the carrying value of an asset is appropriate. Impairment write-downs are recognized in the accompanying condensed consolidated statements of operations and changes in net assets as a component of operating expense at the time the impairment is identified.

## **Property and Equipment, Net**

Property and equipment are reported at cost or, if donated, at fair value at the date of the gift. Costs of computer software developed or obtained for internal use, including external and internal direct costs of materials and labor directly associated with internal-use software development projects, are capitalized and included in property and equipment. Internal labor and interest expense incurred during the period of construction of significant capital projects are capitalized as a component of costs of the asset.

Property and equipment capitalized under direct financing leases are recorded at the present value of future lease payments, adding initial direct costs and prepaid lease payments, reduced by any lease incentives. Property and equipment capitalized under direct financing leases are amortized using the straight-line method over the related lease term. Amortization of property and equipment under financing leases is included in the accompanying condensed consolidated statements of operations and changes in net assets in depreciation and amortization expense.

Property and equipment assets are depreciated on the straight-line method over a period ranging from 3 years to 80 years.

## **Operating Lease Right-of-use Assets**

The System records an operating lease right-of-use asset (an asset that represents the System's right to use the leased asset for the lease term) for leases that do not meet the criteria as a sales-type lease or a direct financing lease.

The System records operating lease right-of-use assets at the present value of future lease payments, adding initial direct costs and prepaid lease payments, reduced by any lease incentives. Operating lease right-of-use assets are amortized using the straight-line method over the related lease term. Amortization of operating lease right-of-use assets is included in the accompanying condensed consolidated statements of operations and changes in net assets in supplies, purchased services and other expense.

Included within operating lease right-of-use assets are assets that the System previously sold and then leased back. Those sale/leaseback transactions, which related to various administrative and medical support buildings, did not meet the accounting criteria as a sales-type lease or a direct financing lease. The buyer-lessors for such transactions are generally unrelated special-purpose entities.

## **Investments in Unconsolidated Entities**

Investments in unconsolidated entities are accounted for using the cost or equity method. The System applies the equity method of accounting for investments in unconsolidated entities when its ownership or membership interest is 50% or less and the System exercises significant influence over the operating and financial policies of the investee. All other unconsolidated entities are accounted for using the cost method. The income (loss) on health care-related unconsolidated entities is included in other revenue in the accompanying condensed consolidated statements of operations and changes in net assets. The income or loss on non-health-related unconsolidated entities is included within other nonoperating income (loss), net.

## **Derivative Financial Instruments**

The System has entered into transactions to manage its interest rate, credit and market risks. Derivative instruments, including exchange-traded and over-the-counter derivative contracts and interest rate swaps, are recorded as either assets or liabilities at fair value. Subsequent changes in a derivatives fair value are recognized in nonoperating income (loss), net.

## **Bond Issuance Costs, Discounts and Premiums**

Bond issuance costs, discounts and premiums are amortized over the term of the bonds using the effective interest method and are included in long-term debt in the accompanying condensed consolidated balance sheets.

## **General and Professional Liability Risks**

The provision for self-insured general and professional liability claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. The System measures the cost of its unfunded obligations under such programs based upon actuarial calculations and records a liability on a discounted basis.

## **Net Assets With Donor Restrictions**

Net assets with donor restrictions are those assets whose use by the System has been limited by donors to a specific time period or purpose or consist of gifts with corpus values that have been restricted by donors to be maintained in perpetuity. Net assets with donor restrictions are used in accordance with the donor's wishes primarily to purchase property and equipment, to fund medical education or to fund health programs.

Assets released from restrictions to fund purchases of property and equipment are reported in the accompanying condensed consolidated statements of operations and changes in net assets as increases to net assets without donor restrictions. Those assets released from restriction for operating purposes are reported in the accompanying condensed consolidated statements of operations and changes in net assets as other revenue. When restricted, earnings are recorded as net assets with donor restrictions until amounts are expended in accordance with the donor's specifications.

## **Nonrecurring Expenses**

The System has incurred salaries, purchased services and other expenses in connection with the formation of the System, the implementation of an electronic medical records and billing system, the implementation of an enterprise resource planning system and, as part of the initiative to reduce operating expenses, an early retirement incentive program and position restructuring. Also recorded in nonrecurring expenses is

the loss incurred on the divestiture of Central Illinois disposal group (See Note 2. SIGNIFICANT EVENTS). Due to the nature of these expenses, the costs were recorded as nonrecurring in the accompanying condensed consolidated statements of operations and changes in net assets.

### **Other Nonoperating Income (Loss), Net**

Revenues and expenses from delivering health care services and the provision of goods and services ancillary thereto are reported in operations. Income and losses that arise from transactions that are peripheral or incidental to the System's main purpose are included in other nonoperating income (loss), net. Other nonoperating income (loss), net primarily consists of a gain on the acquisition of BAMC, fund-raising expenses, contributions to charitable organizations, income taxes and the net non-service components of the periodic benefit expense of the System's pension plans.

### **Revenue in Excess of (Less Than) Expenses and Changes in Net Assets**

The accompanying condensed consolidated statements of operations and changes in net assets includes the revenue in excess of (less than) expenses as the performance indicator. Changes in net assets without donor restrictions, which are excluded from revenue in excess of (less than) expenses, primarily include contributions of long-lived assets (including assets acquired using contributions, which by donor restriction were to be used for the purposes of acquiring such assets), pension-related changes other than net periodic pension costs and distributions to noncontrolling interests.

### **Accounting Pronouncements Adopted**

In February 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-02, Leases (Topic 842). This guidance introduced a lessee model that brings most leases on to the balance sheet. The standard also aligns certain of the underlying principles of the new lessor model with those in ASU 2014-09, the revenue recognition standard. This standard was adopted by the System effective January 1, 2019, using the modified retrospective approach. The System elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allowed the System to carry forward the historical lease classification.

The System recorded a right-of-use asset of \$388,097, which is net of tenant improvements previously recorded prior to adoption of \$38,697, and right-of-use liabilities of \$426,794 due to the adoption of this standard. Additionally, the System recognized a cumulative-effect adjustment of \$23,427 to net assets without donor restrictions on January 1, 2019, related to the deferred gains on various sale-leaseback transactions.

In August 2018, the FASB issued ASU 2018-15, *Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. This guidance requires an entity in a hosting arrangement that is a service contract to follow the guidance in Subtopic 350-40 to determine which implementation costs to capitalize as an asset and which costs to expense as incurred. Also, this guidance requires the entity to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. Further, the guidance requires the entity to present the expense related to the capitalized implementation costs in the same line item in the consolidated statement of operations and changes in net assets as the fees associated with the hosting element (service) of the arrangement and classify payments for capitalized implementation costs in the consolidated statement of cash flows in the same manner as payments made for fees associated with the hosting element. The entity is also required to present the capitalized implementation costs in the condensed consolidated balance sheets in the same line item that a prepayment for the fees of the associated hosting arrangement would be presented. This guidance is effective for fiscal years beginning after December 15, 2020, and interim periods

within annual periods beginning after December 15, 2021. Early adoption is permitted. The System early adopted this guidance effective January 1, 2019, on a prospective basis. This guidance did not have a material impact on the System's accompanying consolidated balance sheets.

#### **4. REVENUE AND RECEIVABLES**

##### **Patient Service Revenue**

Patient service revenue is reported at the amount that reflects the consideration to which the System expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including managed care payors and government programs and excludes revenues for services provided to patients under capitated arrangements) and others and include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations. Generally, patients and third-party payors are billed shortly after discharge. Revenue is recognized as performance obligations are satisfied. Patient service revenue does not include revenue for services provided to patients covered under capitated arrangements.

Performance obligations are identified based on the nature of the services provided. Revenue associated with performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. Performance obligations satisfied over time relate to patients receiving inpatient acute care services. The System measures the performance obligation from admission into the hospital to the point when there are no further services required for the patient, which is generally the time of discharge. For outpatient services, the performance obligation is satisfied as the patient simultaneously receives and consumes the benefits provided as the services are performed. In the case of these outpatient services, recognition of the obligation over time yields the same result as recognizing the obligation at a point in time. Management believes this method provides a faithful depiction of the transfer of services over the term of performance obligations based on the inputs needed to satisfy the obligations.

The System uses a portfolio approach to account for categories of patient contracts as a collective group rather than recognizing revenue on an individual contract basis. The portfolios consist of major payor classes for inpatient revenue and major payor classes and types of services provided for outpatient revenue. Based on the historical collection trends and other analyses, the System believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach were used.

The System determines the transaction price, which involves significant estimates and judgment, based on standard charges for goods and services provided, reduced by explicit and implicit price concessions, including contractual adjustments provided to third-party payors, discounts provided to uninsured and underinsured patients in accordance with policy and/or implicit price concessions based on the historical collection experience of patient accounts. The System determines the transaction price associated with services provided to patients who have third-party payor coverage based on reimbursement terms per contractual agreements, discount policies and historical experience. For uninsured patients who do not qualify for charity care, the System determines the transaction price associated with services based on charges reduced by implicit price concessions. Implicit price concessions included in the estimate of the transaction price are based on historical collection experience for applicable patient portfolios. Patients who meet the System's criteria for charity care are provided care without charge; such amounts are not reported as revenue. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Settlements with third-party payors for retroactive adjustments due to audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care using



the most likely outcome method. These settlements are estimated based on the terms of the payment agreements with the payor, correspondence from the payor and historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as new information becomes available or as years are settled or are no longer subject to such audits, reviews and investigations.

For the nine months ended September 30, 2020 and 2019, changes in the System's estimates of implicit price concessions, discounts and contractual adjustments or other reductions to expected payments for performance obligations related to prior years were not significant.

In certain instances, the System does receive payment in advance of the services provided and would consider these amounts to represent contract liabilities. Contract liabilities at September 30, 2020 and December 31, 2019 were not material.

Currently, the State of Illinois utilizes supplemental reimbursement programs to increase reimbursement to providers to offset a portion of the cost of providing care to Medicaid and indigent patients. These programs are designed with input from the Centers for Medicare and Medicaid Services and are funded with a combination of state and federal resources, including assessments levied on the providers. Under these supplemental programs, the System recognizes revenue and related expenses in the period in which amounts are estimable and collection is reasonably assured. Reimbursement and the assessment under these programs are reflected in the accompanying condensed consolidated statements of operations and changes in net assets are as follows:

		Three Months Ended September 30, 2020	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019	Year Ended December 31, 2019
Reimbursement	Patient service revenue	\$ 77,936	\$ 67,815	\$ 214,163	\$ 203,445	\$ 271,260
Assessment	Supplies, purchased services and other expense	44,351	41,305	126,962	123,916	165,222

The State of Wisconsin assesses a fee or tax on gross patient service revenue. The revenues from this assessment are used to increase payments made to hospitals for services provided to Medicaid and other medically indigent patients. The System's patient service revenue reflects this increase in payment for services to Medicaid and other medically indigent patients and hospital tax assessment expense reflects the fees assessed by the State. Reimbursement and the assessment under these programs is reflected in the accompanying condensed consolidated statements of operations and changes in net assets are as follows:

		Three Months Ended September 30, 2020	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019	Year Ended December 31, 2019
Reimbursement	Patient service revenue	\$ 34,792	\$ 29,322	\$ 103,047	\$ 86,176	\$ 117,150
Assessment	Supplies, purchased services and other expense	25,419	25,368	76,258	75,308	100,777

Management has determined that the nature, amount, timing and uncertainty of revenue and cash flows are affected by the payor's geographical location, the line of business that renders services to patients and the timing of when revenue is recognized and billed.

The composition of patient service revenue by payor is as follows:

Three Months Ended September 30	2020		2019			
Managed care	\$	1,442,658	54%	\$	1,423,369	54%
Medicare		844,013	31		860,662	32
Medicaid - Wisconsin		120,269	5		109,438	4
Medicaid - Illinois		181,289	7		193,672	7
Self-pay and other		68,374	3		72,153	3
	\$	2,656,603	100%	\$	2,659,294	100%

  

Nine Months Ended September 30	2020		2019			
Managed care	\$	3,969,958	54%	\$	4,318,999	55%
Medicare		2,314,746	32		2,434,617	31
Medicaid - Wisconsin		346,978	5		329,505	4
Medicaid - Illinois		520,388	7		572,383	7
Self-pay and other		168,353	2		203,866	3
	\$	7,320,423	100%	\$	7,859,370	100%

  

Year Ended December 31, 2019					
Managed care			\$	5,829,566	55%
Medicare				3,380,458	31
Medicaid - Wisconsin				457,583	4
Medicaid - Illinois				694,406	7
Self-pay and other				298,956	3
			\$	10,660,969	100%

Deductibles, copayments and coinsurance under third-party payment programs, which are the patient's responsibility, are included within the primary payor category in the tables above.

### Capitation Revenue

The System has agreements with various managed care organizations under which the System provides or arranges for medical care to members of the organizations in return for a monthly payment per member. Revenue is earned each month as a result of the System agreeing to provide or arrange for their medical care.

### Other Revenue

Other revenue is recognized at an amount that reflects the consideration to which the System expects to be entitled in exchange for providing goods and services. The amounts recognized reflect consideration due from customers, third-party payors and others. Primary categories of other revenue include grant revenues from the CARES Act, income from joint ventures, retail pharmacy revenue, grant revenue, cafeteria revenue, rent revenue and other miscellaneous revenue.

Revenue disaggregation by state and business line are as follows:

	Three Months Ended September 30, 2020	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019	Year Ended December 31, 2019
Illinois	\$ 1,451,996	\$ 1,537,992	\$ 4,188,098	\$ 4,545,394	\$ 6,086,737
Wisconsin	1,491,909	1,437,711	3,978,546	4,266,867	5,838,394
Total patient service revenue and capitation	2,943,905	2,975,703	8,166,644	8,812,261	11,925,131
Other revenue	508,467	235,285	1,301,404	629,534	880,292
Total revenue	<u>\$ 3,452,372</u>	<u>\$ 3,210,988</u>	<u>\$ 9,468,048</u>	<u>\$ 9,441,795</u>	<u>\$ 12,805,423</u>
Hospital	\$ 1,955,304	\$ 1,969,014	\$ 5,508,097	\$ 5,812,425	\$ 7,859,715
Clinic	612,690	604,132	1,562,977	1,767,625	2,450,681
Home Care	59,661	62,383	175,078	182,470	241,151
Other	28,948	23,765	74,271	96,850	109,422
Total patient service revenue	2,656,603	2,659,294	7,320,423	7,859,370	10,660,969
Capitation revenue	287,302	316,409	846,221	952,891	1,264,162
Other revenue	508,467	235,285	1,301,404	629,534	880,292
Total revenue	<u>\$ 3,452,372</u>	<u>\$ 3,210,988</u>	<u>\$ 9,468,048</u>	<u>\$ 9,441,795</u>	<u>\$ 12,805,423</u>

### Patient Accounts Receivable

The System's patient accounts receivable is reported at the amount that reflects the consideration to which it expects to be entitled, in exchange for providing patient care. Patient accounts receivable are reported at net realizable value based on certain assumptions. For third-party payors including Medicare, Medicaid and Managed Care, the net realizable value is based on the estimated contractual reimbursement percentage, which is based on current contract prices or historical paid claims data by payor. For self-pay, the net realizable value is determined using estimates of historical collection experience including an analysis by aging category. These estimates are adjusted for expected recoveries and any anticipated changes in trends including significant changes in payor mix and economic conditions or trends in federal and state governmental health care coverage.

The composition of patient accounts receivable is summarized as follows:

	September 30, 2020		December 31, 2019	
Managed care	\$ 648,593	44%	\$ 698,731	44%
Medicare	308,904	21	327,723	20
Medicaid - Wisconsin	40,299	3	44,357	3
Medicaid - Illinois	190,176	13	216,618	13
Self-pay and other	299,911	19	318,178	20
	<u>\$ 1,487,883</u>	<u>100%</u>	<u>\$ 1,605,607</u>	<u>100%</u>

The self-pay patient accounts receivable above includes amounts due from patients for co-insurance, deductibles, installment payment plans and amounts due from patients without insurance.

## 5. INVESTMENTS

The System invests in a diversified portfolio of investments, including alternative investments, such as real asset funds, hedge funds and private equity limited partnerships, whose fair value was \$4,033,801 and \$4,123,306 at September 30, 2020 and December 31, 2019, respectively. Collectively, these funds have liquidity terms ranging from daily to annual with notice periods typically ranging from 1 to 90 days. Certain of these investments have redemption restrictions that may restrict redemption for up to 11 years. However, the potential for the System to sell its interest in these funds in a secondary market prior to the end of the fund term does exist for prices at or other than the carrying value.

At September 30, 2020, the System had additional commitments to fund alternative investments, including callable distributions of \$1,423,380 over the next seven years.

In the normal course of operations and within established investment policy guidelines, the System may enter into various exchange-traded and over-the-counter derivative contracts for trading purposes, including futures, options and forward contracts. These instruments are used primarily to maintain the System's strategic asset allocation. These instruments require the System to deposit cash collateral with the broker or custodian. Collateral provided was \$15,850 at September 30, 2020. The notional value of the derivatives in long positions was \$274,311 at September 30, 2020. The notional value of the derivatives in a short position was \$(82,158) at September 30, 2020.

By using derivative financial instruments, the System exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of a derivative contract is positive, the counterparty owes the System, which creates credit risk for the System. When the fair value of a derivative contract is negative, the System owes the counterparty, and therefore, it does not possess credit risk. The System minimizes the credit risk in derivative instruments by entering into transactions that may require the counterparty to post collateral for the benefit of the System based on the credit rating of the counterparty and the fair value of the derivative contract. Market risk is the adverse effect on the value of a financial instrument that results from a change in the underlying reference security. The market risk associated with market changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

Receivables and payables for investment trades not settled are presented with other current assets and accounts payable and accrued liabilities. Unsettled purchases resulted in payables due to brokers of \$71,534 and \$41,977 at September 30, 2020 and December 31, 2019, respectively. Unsettled sales resulted in receivables to brokers of \$71,163 and \$38,355 at September 30, 2020 and December 31, 2019, respectively.

Investment returns for assets limited as to use and cash and cash equivalents are composed of the following:

	Three Months Ended September 30, 2020	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019	Year Ended December 31, 2019
Interest income and dividends	\$ 25,389	\$ 17,147	\$ 55,248	\$ 64,577	\$ 84,684
Income (loss) from alternative investments	40,712	(21,203)	(206,383)	257,308	333,212
Net realized gains (losses)	24,966	7,183	(10,422)	108,937	150,422
Net unrealized gains	262,975	31,523	7,068	330,902	553,287
Total	<u>\$ 354,042</u>	<u>\$ 34,650</u>	<u>\$ (154,489)</u>	<u>\$ 761,724</u>	<u>\$ 1,121,605</u>

Investment returns are included in the accompanying condensed consolidated statements of operations and changes in net assets as follows:

	Three Months Ended September 30, 2020	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019	Year Ended December 31, 2019
Other revenue	\$ 12,894	\$ 19,980	\$ 38,050	\$ 39,074	\$ 53,307
Investment income (loss), net	335,550	13,742	(191,082)	712,768	1,053,898
Net assets with donor restrictions	5,598	928	(1,457)	9,882	14,400
Total	<u>\$ 354,042</u>	<u>\$ 34,650</u>	<u>\$ (154,489)</u>	<u>\$ 761,724</u>	<u>\$ 1,121,605</u>

The cash and cash equivalent and assets limited as to use presented within the accompanying condensed consolidated balance sheets is composed of the following:

	September 30, 2020	December 31, 2019
Internally designated for capital and other	\$ 9,007,979	\$ 8,345,172
Held for self-insurance	621,025	645,697
Donor restricted	128,028	132,024
Investments under securities lending program	16,500	17,672
Total noncurrent assets limited as to use	<u>9,773,532</u>	<u>9,140,565</u>
Cash and cash equivalents	1,248,305	449,712
Current assets limited as to use	110,099	106,529
Total cash and cash equivalents and assets limited as to use	<u>\$ 11,131,936</u>	<u>\$ 9,696,806</u>

## 6. FAIR VALUE

The System accounts for certain assets and liabilities at fair value and categorizes assets and liabilities measured at fair value in the accompanying condensed consolidated financial statements based upon whether the inputs used to determine their fair values are observable or unobservable. Observable inputs are inputs that are based on market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the reporting entity's own assumptions about pricing the asset or liability, based on the best information available under the circumstances.

The fair value of all assets and liabilities recognized or disclosed at fair value is classified based on the lowest level of significant inputs. Assets and liabilities that are measured at fair value are disclosed and classified in one of three categories. Category inputs are defined as follows:

Level 1 — Quoted prices (unadjusted) in active markets for identical assets or liabilities on the reporting date.

Level 2 — Inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 — Inputs that are unobservable for the asset or liability for which there is little or no market data.

The following section describes the valuation methodologies used by the System to measure financial assets and liabilities at fair value. In general, where applicable, the System uses quoted prices in active markets for identical assets and liabilities to determine fair value. This pricing methodology applies to Level 1 investments such as domestic and international equities, exchange-traded funds and agency securities.

If quoted prices in active markets for identical assets and liabilities are not available to determine the fair value, then quoted prices for similar assets and liabilities or inputs other than quoted prices that are observable either directly or indirectly are used. These investments are included in Level 2 and consist primarily of corporate notes and bonds, foreign government bonds, mortgage-backed securities, fixed-income securities, including fixed-income government obligations, commercial paper and certain agency, United States and international equities, which are not traded on an active exchange. The fair value for the obligations under swap agreements included in Level 2 is estimated using industry-standard valuation models. These models project future cash flows and discount the future amounts to a present value using market-based observable inputs, including interest rate curves. The fair values of the obligation under swap agreements include adjustments related to the System's credit risk.

Investments owned by the System are exposed to various kinds and levels of risk. Equity securities and equity funds expose the entity to market risk, performance risk and liquidity risk for both domestic and international investments. Market risk is the risk associated with major movements of the equity markets. Performance risk is that risk associated with a company's operating performance. Fixed-income securities and fixed-income mutual funds expose the System to interest rate risk, credit risk and liquidity risk. As interest rates change, the value of many fixed income securities is affected, including those with fixed interest rates. Credit risk is the risk that the obligor of the security will not fulfill its obligations. Liquidity risk is affected by the willingness of market participants to buy and sell particular securities. Liquidity risk tends to be higher for equities related to small capitalization companies and certain alternative investments. Due to the volatility in the capital markets, there is a reasonable possibility of subsequent changes in fair value resulting in additional gains and losses in the near term.

The carrying values of cash and cash equivalents, accounts receivable and payable, other current assets and accrued liabilities are reasonable estimates of their fair values due to the short-term nature of these financial instruments.

The fair values of financial assets and liabilities that are measured at fair value on a recurring basis are as follows:

	September 30, 2020	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b><u>Assets</u></b>				
<b>Investments</b>				
Cash and short-term investments	\$ 1,988,347	\$ 1,471,274	\$ 517,073	\$ —
Corporate bonds and other debt securities	588,632	—	588,632	—
United States government bonds	458,524	—	458,524	—
Bond and other debt security funds	1,350,451	108,576	1,241,875	—
Non-government fixed-income obligations	22,110	—	22,110	—
Equity securities	695,224	695,224	—	—
Equity funds	1,970,819	120,571	1,850,248	—
	<u>7,074,107</u>	<u>\$ 2,395,645</u>	<u>\$ 4,678,462</u>	<u>\$ —</u>
<b>Investments at net asset value</b>				
Alternative investments	<u>4,057,829</u>			
<b>Total investments</b>	<u>\$ 11,131,936</u>			
<b>Collateral proceeds received under securities lending program</b>				
	<u>\$ 16,971</u>		<u>\$ 16,971</u>	
<b><u>Liabilities</u></b>				
Obligations under swap agreements	<u>\$ (124,388)</u>		<u>\$ (124,388)</u>	
Obligations to return capital under securities lending program	<u>\$ (16,971)</u>		<u>\$ (16,971)</u>	

	December 31, 2019	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets</b>				
<b>Investments</b>				
Cash and short-term investments	\$ 909,297	\$ 872,262	\$ 37,035	\$ —
Corporate bonds and other debt securities	582,327	—	582,327	—
United States government bonds	583,429	—	583,429	—
Bond and other debt security funds	688,728	102,555	586,173	—
Non-government fixed-income obligations	26,176	—	26,176	—
Equity securities	782,581	782,581	—	—
Equity funds	1,976,779	134,951	1,841,828	—
	<u>5,549,317</u>	<u>\$ 1,892,349</u>	<u>\$ 3,656,968</u>	<u>—</u>
<b>Investments at net asset value</b>				
Alternative investments	4,147,489			
<b>Total investments</b>	<u>\$ 9,696,806</u>			
<b>Collateral proceeds received under securities lending program</b>				
	<u>\$ 18,284</u>		<u>\$ 18,284</u>	
<b>Liabilities</b>				
<b>Obligations under swap agreements</b>	<u>\$ (91,340)</u>		<u>\$ (91,340)</u>	
<b>Obligations to return capital under securities lending program</b>				
	<u>\$ (18,284)</u>		<u>\$ (18,284)</u>	

## 7. PROPERTY AND EQUIPMENT, NET

The components of property and equipment are summarized as follows:

	September 30, 2020	December 31, 2019
Land and improvements	\$ 481,238	\$ 497,363
Buildings and fixed equipment	7,582,541	7,519,607
Movable equipment and computer software	2,579,273	2,496,988
Construction-in-progress	377,294	355,733
	<u>11,020,346</u>	<u>10,869,691</u>
Accumulated depreciation and amortization	(5,245,501)	(4,967,768)
Property and equipment, net	<u>\$ 5,774,845</u>	<u>\$ 5,901,923</u>

Property and equipment include assets recorded as finance leases and under other financing arrangements. See additional disclosure in Note 8. LEASES.

Depreciation expense is as follows:

	Three Months Ended September 30, 2020	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019	Year Ended December 31, 2019
Depreciation expense	<u>\$ 136,140</u>	<u>\$ 137,685</u>	<u>\$ 412,565</u>	<u>\$ 414,567</u>	<u>\$ 560,221</u>



## 8. LEASES

The System leases office and clinical space, land and equipment. Leases with an initial term of 12 months or less are not recorded on the balance sheet. For lease agreements entered into after the adoption of ASU 2016-02 on January 1, 2019, the System combines lease and non-lease components except for medical equipment leases.

The depreciable lives of assets are limited by the expected lease terms. Most leases include options to renew. The majority of leases do not provide an implicit rate; therefore, the System has elected to use its incremental borrowing rate, which is the interest rate the System would borrow on a collateralized basis over a similar term, as the discount rate. The System used its incremental borrowing rate on January 1, 2019, for operating leases that commenced prior to that date.

Operating and finance leases are classified as follows within the accompanying condensed consolidated balance sheets:

Leases	Classification	September 30, 2020	December 31, 2019
Assets			
Operating	Operating lease right-of-use assets	\$ 321,858	\$ 352,295
Finance	Property and equipment, net	150,128	161,970
Total lease assets		<u>\$ 471,986</u>	<u>\$ 514,265</u>
Liabilities			
Current			
Operating	Current portion of operating lease liabilities	\$ 78,359	\$ 77,957
Finance	Current portion of long-term debt and commercial paper	8,524	8,445
Noncurrent			
Operating	Operating lease liabilities	281,389	314,106
Finance	Long-term debt, less current portion	165,680	176,811
Total lease liabilities		<u>\$ 533,952</u>	<u>\$ 577,319</u>

Finance lease assets are recorded net of accumulated amortization of \$56,137 and \$49,743 as of September 30, 2020 and December 31, 2019, respectively.

Lease costs are classified as follows within the accompanying condensed consolidated statements of operations and changes in net assets:

Lease cost	Classification	Three Months Ended September 30, 2020	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019	Year Ended December 31, 2020
Operating lease cost	Supplies, purchased services and other	\$ 21,094	\$ 21,393	\$ 64,123	\$ 63,434	\$ 85,037
Short term lease cost	Supplies, purchased services and other	3,122	2,328	10,449	8,302	10,686
Variable lease cost	Supplies, purchased services and other	10,684	9,134	27,077	20,908	29,099
Finance lease cost						
Amortization of lease assets	Depreciation and amortization	2,687	2,857	8,368	7,735	10,719
Interest on lease liabilities	Interest	2,973	2,929	9,151	6,955	10,053
Sublease income	Other revenue	(612)	(604)	(1,827)	(1,982)	(2,593)
Net lease cost		<u>\$ 39,948</u>	<u>\$ 38,037</u>	<u>\$ 117,341</u>	<u>\$ 105,352</u>	<u>\$ 143,001</u>

Lease terms, discount rates and other supplemental information are as follows:

	As of September 30, 2020	As of September 30, 2019	As of December 31, 2019
Weighted average remaining lease term (in years)			
Operating	5.6	5.8	6.0
Finance	11.8	13.1	12.9
Weighted average discount rate			
Operating	2.27%	2.32%	2.34%
Finance	7.59%	7.43%	7.44%

	Three Months Ended September 30, 2020	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019	Year Ended December 31, 2019
Cash paid for amounts included in the measurement of lease liabilities					
Operating cash flows from operating leases	\$ 21,912	\$ 21,804	\$ 66,346	\$ 65,365	\$ 86,504
Operating cash flows from finance leases	2,492	3,070	9,151	7,294	10,563
Financing cash flows from finance leases	2,795	2,192	6,777	5,695	7,605

Future maturities of lease liabilities at September 30, 2020 are as follows:

	Operating Leases	Finance Leases	Total
2020	\$ 21,805	\$ 4,016	\$ 25,821
2021	84,567	20,419	104,986
2022	74,107	20,804	94,911
2023	63,454	20,741	84,195
2024	47,264	21,242	68,506
Thereafter	93,328	189,007	282,335
Future minimum lease payments	384,525	276,229	660,754
Less remaining imputed interest	24,777	102,025	126,802
Total	\$ 359,748	\$ 174,204	\$ 533,952

## 9. INVESTMENTS IN UNCONSOLIDATED ENTITIES

The System contributed \$25,000 to an independent foundation in conjunction with the Bay Area Medical Center ("BAMC") transaction. See the additional discussion of this transaction in Note 17. ACQUISITION OF BAY AREA MEDICAL CENTER. Under the terms of the definitive agreement between the System and BAMC, the \$25,000 contribution is designated to support the operations and capital needs of BAMC and/or Aurora Bay Area Medical Group ("ABAMG"). The interest in that foundation is reflected in investments in unconsolidated entities in the accompanying condensed consolidated balance sheets, which amounted to \$19,143 and \$21,186 at September 30, 2020 and December 31, 2019, respectively. Cash distributions of \$630 and \$2,043 were received by BAMC from this Foundation under terms of the definitive agreement during the three and nine months ended September 30, 2020, respectively.

The System has an interest in the net assets of the Masonic Family Health Foundation ("MFHF"), an independent organization, under the terms of an asset purchase agreement (the "Agreement"). Substantially all of MFHF's net assets are designated to support the operations and/or capital needs of one of the System's medical facilities. Additionally, 90% of MFHF's investment yield, net of expenses, on substantially all of MFHF's investments is designated for the support of one of the System's medical facilities. MFHF must pay the System, annually, 90% of the investment yield or an agreed-upon percentage of the beginning of the year net assets.

The interest in the net assets of MFHF amounted to \$94,578 and \$99,827 at September 30, 2020 and December 31, 2019, respectively, and is presented within investments in unconsolidated entities in the accompanying condensed consolidated balance sheets. The System's interest in the investment income is reflected in the accompanying condensed consolidated statements of operations and changes in net assets and amounted to \$7,928 and \$793 for the three ended September 30, 2020 and September 30, 2019, respectively and \$8,999 and \$13,549 for the nine months ended September 30, 2020 and September 30, 2019, respectively. Cash distributions of \$0 were received by the System from MFHF under terms of the Agreement during the three months ended September 30, 2020 and September 30, 2019 and \$3,978 and \$3,347 during the nine months ended September 30, 2020 and September 30, 2019, respectively. In addition, MFHF made \$0 contributions to the System for program support during the nine months ended September 30, 2020 and September 30, 2019.

At September 30, 2020, the System had a 49.5% ownership interest in RML Health Providers, L.P. ("RML") that is accounted for on an equity basis. RML is an Illinois not-for-profit limited partnership that operates a 115-bed licensed long-term acute care hospital in Hinsdale, Illinois, and an 86-bed licensed long-term acute care hospital in Chicago, Illinois. The System's investment in RML was \$31,896 and \$33,462 at September 30, 2020 and December 31, 2019, respectively, and is presented within investments in unconsolidated entities in the accompanying condensed consolidated balance sheets.

RML leases the Chicago, Illinois, facility from the System. The lease has a fixed term through June 30, 2025. The System recorded rental income of \$302 and \$294 for the three months ended September 30, 2020 and September 30, 2019, respectively and \$890 and \$864 for the nine months ended September 30, 2020 and September 30, 2019, respectively.

The summarized financial position and results of operations for significant entities accounted for under the equity method as of and for the periods ended is outlined below:

	<u>RML</u>	<u>MFHF</u>
<b>As of September 30, 2020</b>		
Total assets	\$ 125,870	\$ 104,081
Total liabilities	59,680	3,043
Partners' equity/net assets	66,190	101,038
<b>Three Months Ended September 30, 2020</b>		
Total revenue	31,327	7,793
Revenue less than expenses	4,291	6,396
<b>Three Months Ended September 30, 2019</b>		
Total revenue	28,801	801
Revenue in excess of expenses	2,124	(27)
<b>Nine Months Ended September 30, 2020</b>		
Total revenue	91,084	8,884
Revenue less than expenses	10,092	5,403
<b>Nine Months Ended September 30, 2019</b>		
Total revenue	84,599	13,554
Revenue less than expenses	10,371	10,566
<b>As of December 31, 2019</b>		
Total assets	123,345	99,827
Total liabilities	55,118	4,192
Partners' equity/net assets	68,227	95,635

## 10. LONG-TERM DEBT

The System's outstanding bonds are secured by obligations issued under the Second Amended and Restated Master Trust Indenture dated as of August 1, 2018, as the same may be amended from time to time, between Advocate Aurora Health, Inc., the other affiliates identified therein as the Members of the Obligated Group and U.S. Bank National Association, as master trustee ("the System Master Indenture"). Under the terms of the bond indentures and other arrangements, various amounts are to be on deposit with trustees, and certain specified payments are required for bond redemption and interest payments. The System Master Indenture and other debt agreements, including bank agreements, also place restrictions on the System and require the System to maintain certain financial ratios.

At December 31, 2019, the System had unsecured variable rate revenue bonds, Series 2008A-1 of \$42,045, Series 2008A-2 of \$35,490 and Series 2011B of \$70,000. In 2020, the Series 2008A-1 and Series 2008A-2 bonds were remarketed at a premium to their maturity date of November 1, 2030 and a portion of the outstanding par was redeemed in the amount of \$5,590 and \$4,670, respectively. The System's unsecured variable rate revenue bonds, while subject to a long-term amortization period, may be put to the System at the option of the bondholders in connection with certain remarketing dates. To the extent that bondholders may, under the terms of the debt, put their bonds within 12 months after the balance sheet date, the principal amount of such bonds has been classified as a current obligation in the accompanying condensed consolidated balance sheets. Management believes the likelihood of a material amount of bonds being put to the System is remote. However, to address this possibility, the System has taken steps to provide various sources of liquidity, including assessing alternate sources of financing, including lines of credit and/or net assets without donor restrictions as a source of self-liquidity.

The Series 2018C-1 Bonds were classified as current liabilities as of September 30, 2020, as these bonds are subject to mandatory tender on a date that was within one year of the balance sheet date.

The System has standby bond purchase agreements with banks to provide liquidity support for the Series 2008C Bonds. In the event of a failed remarketing of a Series 2008C Bond upon its tender by an existing holder and subject to compliance with the terms of the standby bond purchase agreement, the standby bank would provide the funds for the purchase of such tendered bonds, and the System would be obligated to repay the bank for the funds it provided for such bond purchase (if such bond is not subsequently remarketed), with the first installment of such repayment commencing on the date one year and one day after the bank purchases the bond. As of September 30, 2020, there were no bank-purchased bonds outstanding. To the extent that the standby bond purchase agreement expiration date is within 12 months after September 30, 2020, the principal amount of such bonds would be classified as a current obligation in the accompanying condensed consolidated balance sheets. The standby bond purchase agreements expire as follows: \$129,456 in January 2024, \$87,694 in September 2024 and \$58,225 in September 2025.

In March 2019, the System issued commercial paper in the amount of \$50,000. The proceeds of the commercial paper were used to redeem the Series 2008C-2A bonds of \$49,230 plus accrued interest and certain costs related to the issuance of the commercial paper. The remaining proceeds were used for general corporate purposes.

In connection with the BAMC acquisition, the System assumed \$81,465 of outstanding tax-exempt bonds originally issued for the benefit of BAMC, which redeemed in November 2019 with a portion of the proceeds of \$82,000 of the System's commercial paper. Also in connection with the BAMC acquisition, the System acquired an interest rate swap. As the debt related to the swap is no longer outstanding, it is being held as a swap portfolio. This swap is secured under the System Master Indenture.

In November 2019, the System issued its Series 2019 Taxable Bonds in the amount of \$357,970. The proceeds of the Series 2019 Taxable Bonds were used to refinance all or a portion of the Series 2011A-2, Series 2012, Series 2013A and Series 2014 Bonds and to pay certain financing costs. In connection with this issuance, the System recognized a loss on refinancing in the amount of \$21,103.

In May 2020, the System issued its Series 2020A Taxable Bonds in the aggregate principal amount of \$700,000. The proceeds of the Series 2020A Taxable Bonds were used for general corporate purposes, to refinance a portion of the Series 2011B, Series 2011C, Series 2011D, Series 2012, Series 2013A, Series 2015 and Series 2015B Bonds, to repay \$82,000 of commercial paper and to pay certain financing costs. In connection with this transaction, the System recognized a loss on refinancing in the amount of \$12,231.

As of September 30, 2020, the System has authorized the issuance of up to \$1,000,000 in commercial paper aggregate principal outstanding. As of September 30, 2020, \$50,000 of commercial paper notes was outstanding with maturities ranging from 98 to 122 days.

At September 30, 2020, the System had lines of credit with banks aggregating to \$1,350,000 in available commitments. These lines of credit provide for various interest rates and payment terms and as of September 30, 2020 expire as follows: \$1,150,000 in April 2021, \$100,000 in August 2021 and \$100,000 in December 2022. These lines of credit may be used to redeem bonded indebtedness, to pay costs related to such redemptions, for capital expenditures, for general working capital purposes or to provide for certain letters of credit. As of September 30, 2020, letters of credit totaling \$58,326 have been issued under one of these lines. At September 30, 2020, no amounts were outstanding on these lines or letters of credit.

The System maintains an interest rate swap program on certain of its variable rate debt as described in Note 11. INTEREST RATE SWAP PROGRAM.

The System's interest paid, net of capitalized interest and capitalized interest are as follows:

	Three Months Ended September 30, 2020	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019	Year Ended December 31, 2019
Interest paid, net of capitalized interest	\$ 29,635	\$ 37,832	\$ 80,131	\$ 97,863	\$ 119,870
Capitalized interest	420	1,290	1,347	2,555	4,087

## 11. INTEREST RATE SWAP PROGRAM

The System has interest rate-related derivative instruments to manage the exposure of its variable rate debt instruments. By using derivative financial instruments to manage the risk of changes in interest rates, the System exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of a derivative contract is positive, the counterparty owes the System, which creates credit risk for the System. When the fair value of a derivative contract is negative, the System owes the counterparty, and therefore, it does not possess credit risk. The System minimizes the credit risk in derivative instruments by entering into transactions that may require the counterparty to post collateral for the benefit of the System based on the credit rating of the counterparty and the fair value of the derivative contract. Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. The System also mitigates risk through periodic reviews of its derivative positions in the context of its total blended cost of capital.

At September 30, 2020, the System maintains an interest rate swap program for its Series 2008C bonds. These bonds expose the System to variability in interest payments due to changes in interest rates. The

System believes that it is prudent to limit the variability of its interest payments. To meet this objective and to take advantage of low interest rates, the System entered into various interest rate swap agreements to manage fluctuations in cash flows resulting from interest rate risk. These swaps convert the variable rate cash flow exposure on the variable rate demand revenue bonds to synthetically fixed cash flows. The notional amount under each interest rate swap agreement is reduced over the term of the respective agreement to correspond with reductions in the principal outstanding under various bond series. As the Series 2008C-2A bonds were redeemed on March 5, 2019, the portion of the swap related to these bonds is now held as a swap portfolio.

In connection with the BAMC acquisition, the System acquired an interest rate swap. As the debt related to the swap is no longer outstanding, it is being held as a swap portfolio.

The following is a summary of the outstanding positions under these interest rate swap agreements at September 30, 2020:

Bond Series	Notional Amount	Maturity Date	Rate Received	Rate Paid
2008C-1	\$ 129,900	November 1, 2038	61.7% of LIBOR + 26bps	3.605%
2008C-2B	58,425	November 1, 2038	61.7% of LIBOR + 26bps	3.605%
2008C-3A	88,000	November 1, 2038	61.7% of LIBOR + 26bps	3.605%
Swap portfolio	50,000	November 1, 2038	61.7% of LIBOR + 26bps	3.605%
Swap portfolio	26,170	February 1, 2038	70.0% of LIBOR	3.314%

The swaps are not designated as hedging instruments, and therefore, hedge accounting has not been applied. As such, unrealized changes in fair value of the swaps are classified as changes in fair value of interest rate swaps in the accompanying condensed consolidated statements of operations and changes in net assets. The net cash settlement payments, representing the realized changes in fair value of the swaps, are included as interest expense in the accompanying condensed consolidated statements of operations and changes in net assets.

The fair value of the interest rate swap agreements was a liability of \$124,388 and \$91,340 as of September 30, 2020 and December 31, 2019, respectively. No collateral was posted under these swap agreements as of September 30, 2020 and December 31, 2019.

Amounts recorded in the condensed consolidated statements of operations and changes in net assets are as follows:

	Three Months Ended September 30, 2020	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019	Year Ended December 31, 2019
Net cash payments on interest rate swap agreements (interest expense)	\$ 2,815	\$ 1,697	\$ 7,379	\$ 4,566	\$ 6,711
Change in fair value of interest rate swaps	\$ 3,587	\$ (13,650)	\$ (33,048)	\$ (34,298)	\$ (21,079)

The interest rate swap instruments contain provisions that require the System to maintain an investment grade credit rating on its bonds from certain major credit rating agencies. If the System's bonds were to fall below investment grade, it would be in violation of these provisions and the counterparties to the swap instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on interest rate swap instruments in net liability positions.

## 12. RETIREMENT PLANS

The System maintains various employee retirement benefit plans available to qualifying employees and retirees.

In June 2019, the System approved a plan to freeze the Advocate Health Care Network Pension Plan ("Advocate Plan") that covered substantially all of Advocate's employees. Effective December 31, 2019, the Advocate Plan closed to new participants and participants ceased accruing additional pension benefits. The Advocate Plan was remeasured as of June 30, 2019 and a curtailment loss of \$72 was recorded in nonoperating (loss) income, net in the accompanying condensed consolidated statements of operations and changes in net assets. In addition, \$86,396 of previously unrecognized net actuarial loss was recognized in net assets without donor restrictions as a component of pension-related changes other than net periodic pension cost. The accompanying condensed consolidated balance sheets contain an other noncurrent liability related to the Advocate Plan totaling \$153,556 and \$173,939 at September 30, 2020 and December 31, 2019, respectively. During the three and nine months ended September 30, 2020, \$0 and \$40,000, respectively, in cash contributions were made to the Advocate Plan.

In addition, the accompanying condensed consolidated balance sheets contain an other noncurrent asset and other noncurrent liability related to the Condell Health Network Retirement Plan ("Condell Plan") of \$6,097 and \$1,824 at September 30, 2020 and December 31, 2019, respectively. The Condell Plan was frozen effective January 1, 2008, to new participants and participants ceased to accrue additional pension benefits. During the three and nine months ended September 30, 2020, \$3,000 cash contributions were made to the Condell Plan.

The accompanying condensed consolidated balance sheets contain an other noncurrent liability related to the Aurora defined benefit pension plan ("Aurora Plan") of \$80,205 and \$83,321 at September 30, 2020 and December 31, 2019, respectively. The Aurora Plan was frozen on December 31, 2012. During the three and nine months ended September 30, 2020, no cash contributions were made to the Aurora plan.

In September 2020, the System transferred benefit obligations for certain participants of the Advocate Plan, Condell Plan and Aurora Plan through the purchase of annuity contracts. As a result of this transaction, all three Plans were remeasured as September 30, 2020 and a combined settlement loss of \$119,658 was recorded in the nonoperating income (loss) section in the accompanying condensed consolidated statements of operations and changes in net assets.

Pension plan expense (income) included in the accompanying condensed consolidated statements of operations and changes in net assets is as follows:

**Three Months Ended September 30, 2020**

	<b>Advocate</b>	<b>Condell</b>	<b>Aurora</b>	<b>Total</b>
Interest cost	\$ 9,287	\$ 536	\$ 13,823	\$ 23,646
Expected return on plan assets	(10,999)	(365)	(16,554)	(27,918)
Amortization of:				
Actuarial loss	1,287	88	2,997	4,372
Prior service cost	—	—	1	1
Settlement/curtailment	28,106	1,828	89,724	119,658
Net pension expense	<u>\$ 27,681</u>	<u>\$ 2,087</u>	<u>\$ 89,991</u>	<u>\$ 119,759</u>

**Three Months Ended September 30, 2019**

	<b>Advocate</b>	<b>Condell</b>	<b>Aurora</b>	<b>Total</b>
Service cost	\$ 14,520	\$ —	\$ —	\$ 14,520
Interest cost	8,498	582	15,662	24,742
Expected return on plan assets	(11,595)	(604)	(19,046)	(31,245)
Amortization of:				
Actuarial loss	—	27	1,908	1,935
Prior service cost	—	—	1	1
Net pension expense (income)	<u>\$ 11,423</u>	<u>\$ 5</u>	<u>\$ (1,475)</u>	<u>\$ 9,953</u>

**Nine Months Ended September 30, 2020**

	<b>Advocate</b>	<b>Condell</b>	<b>Aurora</b>	<b>Total</b>
Interest cost	\$ 27,859	\$ 1,608	\$ 41,469	\$ 70,936
Expected return on plan assets	(32,996)	(1,095)	(49,663)	(83,754)
Amortization of:				
Actuarial loss	3,862	266	8,992	13,120
Prior service cost	—	—	2	2
Settlement/curtailment	28,106	1,828	89,724	119,658
Net pension expense	<u>\$ 26,831</u>	<u>\$ 2,607</u>	<u>\$ 90,524</u>	<u>\$ 119,962</u>

**Nine Months Ended September 30, 2019**

	<b>Advocate</b>	<b>Condell</b>	<b>Aurora</b>	<b>Total</b>
Service cost	\$ 43,126	\$ —	\$ —	\$ 43,126
Interest cost	29,884	1,746	46,986	78,616
Expected return on plan assets	(43,947)	(1,812)	(57,137)	(102,896)
Amortization of:				
Actuarial loss	3,634	81	5,723	9,438
Prior service cost	(72)	—	2	(70)
Settlement/curtailment	(72)	—	—	(72)
Net pension expense (income)	<u>\$ 32,553</u>	<u>\$ 15</u>	<u>\$ (4,426)</u>	<u>\$ 28,142</u>

**Year Ended December 31, 2019**

	<b>Advocate</b>	<b>Condell</b>	<b>Aurora</b>	<b>Total</b>
Service cost	\$ 57,645	\$ —	\$ —	\$ 57,645
Interest cost	38,384	2,327	62,649	103,360
Expected return on plan assets	(55,543)	(2,413)	(76,183)	(134,139)
Amortization of:				
Actuarial loss	3,634	108	7,631	11,373
Prior service cost	(72)	—	3	(69)
Settlement/curtailment	(72)	642	—	570
Net pension expense (income)	<u>\$ 43,976</u>	<u>\$ 664</u>	<u>\$ (5,900)</u>	<u>\$ 38,740</u>



The components of net periodic benefit costs other than the service cost component are included in other nonoperating (loss) income, net in the accompanying condensed consolidated statements of operations and changes in net assets.

The expected employee benefit payments to be paid from the pension plans are as follows:

	<b>Advocate</b>	<b>Condell</b>	<b>Aurora</b>	<b>Total</b>
October 2020- September 2021	\$ 60,746	\$ 4,854	\$ 41,230	\$ 106,830
October 2021- September 2022	60,291	3,778	45,762	109,831
October 2022- September 2023	60,635	3,218	49,789	113,642
October 2023- September 2024	60,247	3,316	53,396	116,959
October 2024- September 2025	59,710	3,109	56,755	119,574
October 2025- September 2030	284,042	16,089	322,804	622,935
Total	<u>\$ 585,671</u>	<u>\$ 34,364</u>	<u>\$ 569,736</u>	<u>\$ 1,189,771</u>

The System's asset allocation and investment strategies are designed to earn returns on plan assets consistent with a reasonable and prudent level of risk. Investments are diversified across classes, economic sectors and manager style to minimize the risk of loss. The System utilizes investment managers specializing in each asset category and, where appropriate, provides the investment manager with specific guidelines that include allowable and/or prohibited investment types. The System regularly monitors manager performance and compliance with investment guidelines.

The System's target and actual pension asset allocations for the plans are as follows:

<b>Asset Category - Advocate Plan</b>	<b>September 30, 2020</b>		<b>December 31, 2019</b>	
	<b>Target</b>	<b>Actual</b>	<b>Target</b>	<b>Actual</b>
De-risking portfolio	67%	67%	75%	58%
Domestic and international equity securities	18	18	21	20
Alternative investments	8	8	2	13
Cash and fixed-income securities	7	7	2	9
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

  

<b>Asset Category - Condell Plan</b>	<b>September 30, 2020</b>		<b>December 31, 2019</b>	
	<b>Target</b>	<b>Actual</b>	<b>Target</b>	<b>Actual</b>
De-risking portfolio	90%	90%	85%	85%
Domestic and international equity securities	4	4	6	6
Cash and fixed-income securities	6	6	9	9
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

  

<b>Asset Category - Aurora Plan</b>	<b>September 30, 2020</b>		<b>December 31, 2019</b>	
	<b>Target</b>	<b>Actual</b>	<b>Target</b>	<b>Actual</b>
De-risking portfolio	85%	73%	75%	73%
Domestic and international equity securities	12	18	21	22
Alternative investments	1	2	2	2
Cash and fixed-income securities	2	7	2	3
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

Assumptions used to determine benefit obligations are as follows:

	<u>December 31, 2020</u>
Discount rate - Advocate Plan	2.67%
Discount rate - Condell Plan	2.96%
Discount rate - Aurora Plan	2.95%
Assumed rate of return on assets - Advocate Plan	4.60%
Assumed rate of return on assets - Condell Plan	2.90%
Assumed rate of return on assets - Aurora Plan	3.80%

The assumed rate of return on each Plan's assets is based on historical and projected rates of return for asset classes in which the portfolio is invested. The de-risking portfolio is comprised of fixed income instruments designed to hedge Plan liabilities. As the Advocate Plan was frozen on December 31, 2019, the assumed rate of return and the target asset allocations were adjusted and actual allocations are being adjusted to more closely align with the new target allocations.

In addition to these plans, the System sponsors defined contribution plans for its employees. As of January 1, 2020, three plans were merged into one existing plan, the Advocate Health Care Network 401(k) plan. At this time the Advocate Health Care Network 401(k) plan was restated and became known as the Advocate Aurora Health 401(k) plan ("AAH 401(k)"). On June 30, 2020, one final plan was merged into the AAH 401(k) plan. Effective January 1, 2020, the AAH 401(k) contribution plan was enhanced to add an annual contribution component to the employer match. Expense related to these plans, which are included in salaries, wages and benefits expense in the condensed consolidated statements of operations and changes in net assets are as follows:

	<u>Three Months Ended September 30, 2020</u>	<u>Three Months Ended September 30, 2019</u>	<u>Nine Months Ended September 30, 2020</u>	<u>Nine Months Ended September 30, 2019</u>	<u>Year Ended December 31, 2019</u>
Defined contribution plan expense	\$ 77,138	\$ 51,998	\$ 229,936	\$ 162,053	\$ 207,194

### 13. FUNCTIONAL EXPENSES

For the nine months ended September 30, 2020 and September 30, 2019, the majority of the System's expenses were directly attributable to the provision of health care services. The remaining expenses, primarily legal, finance, purchasing and human resources were attributable to general and administrative functions. Health care services require the benefit of and the expense of general and administrative services; therefore, these costs would be further allocated to health care services. Fundraising expense are primarily reported within other nonoperating income (loss), net in the accompanying condensed consolidated statements of operations and changes in net assets.

## 14. LIQUIDITY

The System's financial assets available within one year of the consolidated balance sheets date for general expenditures are as follows:

	September 30, 2020	December 31, 2019
Current assets		
Cash and cash equivalents	\$ 1,248,305	\$ 449,712
Assets limited as to use	110,099	106,529
Patient accounts receivable	1,487,883	1,605,607
Third-party payors receivables	39,507	15,331
Collateral proceeds under securities lending program	16,971	18,284
Total current assets	2,902,765	2,195,463
Assets limited as to use		
Internally designated for capital and other	9,007,979	8,345,172
Held for self-insurance	621,025	645,697
Donor restricted	128,028	132,024
Investments under securities lending program	16,500	17,672
Total assets limited as to use	9,773,532	9,140,565
Total financial assets	12,676,297	11,336,028
Less		
Amounts unavailable for general expenditures		
Alternative investments	(1,909,414)	(1,791,717)
Total amounts unavailable for general expenditure	(1,909,414)	(1,791,717)
Amounts unavailable to management without approval		
Held for self-insurance	(731,124)	(752,226)
Donor restricted	(128,028)	(132,024)
Investments under securities lending program	(16,500)	(17,672)
Total amounts unavailable to management without approval	(875,652)	(901,922)
Total financial assets available to management for general expenditure within one year	\$ 9,891,231	\$ 8,642,389

## 15. GENERAL AND PROFESSIONAL LIABILITY RISKS

The System is self-insured for substantially all general and professional liability risks. The self-insurance programs combine various levels of self-insured retention with excess commercial insurance coverage. In addition, various umbrella insurance policies have been purchased to provide coverage in excess of the self-insured limits. Revocable trust funds, administered by a trustee and a captive insurance companies, have been established for the self-insurance programs. Actuarial consultants have been retained to determine the estimated cost of claims, as well as to determine the amount to fund into the irrevocable trust and captive insurance companies.

The System's hospitals, clinics, surgery centers, physicians and certified registered nurse anesthetist providers that provide health care in Wisconsin are qualified health care providers that are fully covered for losses in excess of statutory limits through mandatory participation in the State of Wisconsin Injured Patients and Families Compensation Fund.

The estimated cost of claims is actuarially determined based on past experience, as well as other considerations, including the nature of each claim or incident and relevant trend factors. Accrued insurance liabilities and contributions to the trust were determined using a discount rate of 3.00% as of September 30, 2020 and December 31, 2019.

The System entities are defendants in certain litigation related to professional and general liability risks, and other matters. Although the outcome of the litigation cannot be determined with certainty, management believes, after consultation with legal counsel, that the ultimate resolution of the litigations will not have a material adverse effect on the System's operations or financial condition.

## **16. LEGAL, REGULATORY AND OTHER CONTINGENCIES**

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. During the last few years, due to nationwide investigations by governmental agencies, various health care organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, exclusion from the Medicare and Medicaid programs and revocation of federal or state tax-exempt status. Moreover, the System expects that the level of review and audit to which it and other health care providers are subject will increase.

Various federal and state agencies have initiated investigations, which are in various stages of discovery, relating to reimbursement, billing practices and other matters of the System. There can be no assurance that regulatory authorities will not challenge the System's compliance with these laws and regulations, and it is not possible to determine the impact, if any, such claims or penalties would have on the System. To foster compliance with applicable laws and regulations, the System maintains a compliance program designed to detect and correct potential violations of laws and regulations related to its programs.

## **17. ACQUISITION OF BAY AREA MEDICAL CENTER**

The System had a 49% interest in Bay Area Medical Center ("BAMC") that was accounted for under the equity method of accounting until the remaining equity interest was purchased on April 1, 2019. BAMC is a 99-bed general acute care hospital located in Marinette, Wisconsin.

At the time of the acquisition, BAMC and the System owned a 73% and 27% interest, respectively, in Aurora Bay Area Medical Group ("ABAMG"). ABAMG provides inpatient, outpatient and other professional medical services in Marinette, Wisconsin and its surrounding communities. As part of the acquisition of BAMC, the System now owns 100% of ABAMG and its financial results are included in the consolidated financial statements of the System.

The acquisition will improve the availability, scope and access to health care in the communities served by BAMC. As of April 1, 2019, BAMC and ABAMG are fully consolidated within the accompanying condensed consolidated financial statements of the System.

In conjunction with the BAMC transaction, the System contributed \$25,000 to a newly formed independent foundation. This interest in that foundation is reflected in investments in unconsolidated entities in the accompanying condensed consolidated balance sheets. Under the terms of the definitive agreement between the System and BAMC, the use of the \$25,000 contribution is designated to support the operations and capital needs of BAMC and/or ABAMG.

As the System previously had an interest in BAMC, this transaction was accounted for as an acquisition achieved in stages. The System remeasured its previously held equity interest in BAMC to fair market value resulting in a gain of \$44,000, which was recorded within nonoperating (loss) income in the condensed consolidated statements of operations and changes in net assets. The System then recorded its 100% interest in BAMC at fair market value, resulting in an inherent contribution of \$37,736, which was recorded

within nonoperating (loss) income in the condensed consolidated statements of operations and changes in net assets.

The fair value of assets and liabilities of BAMC acquisition at April 1, 2019 consisted of the following:

Current assets	\$	37,239
Assets limited as to use		18,795
Property and equipment		157,206
Other noncurrent assets		7,879
Other intangible assets		460
Total assets	\$	<u>221,579</u>
Current liabilities		19,812
Long-term debt, less current portion		78,959
Other noncurrent liabilities		12,080
Total liabilities		<u>110,851</u>
Net assets with donor restrictions		792
Net assets without donor restrictions		109,936
Total liabilities and net assets	\$	<u>221,579</u>

Total 2019 revenue and operating loss from the date of acquisition for BAMC of \$109,309 and \$(9,599), respectively were included in the condensed consolidated statements of operations and changes in net assets. The 2019 BAMC related changes in net assets without donor restrictions of \$(13,074) from the date of acquisition is included in the condensed consolidated balance sheets.

The proforma financial information presented below were prepared on a consolidated basis utilizing the accounting records of the System and BAMC as if the acquisition had occurred for the entirety of the period presented. The proforma information presented have been adjusted to eliminate activity between the System and BAMC. Management believes the assumptions underlying the proforma financial information presented, including the assumptions regarding the elimination of intercompany activity are reasonable. Nevertheless, the proforma information may not reflect the results of operations had BAMC been a combined company during the periods presented and is not intended to project the System's results of operations for any future periods.

	Year Ended December 31, 2019
Total revenue	\$ 12,833,303
Operating income	480,701
Revenues in excess of expenses	1,546,032

## 18. SUBSEQUENT EVENTS

The System evaluated events and transactions subsequent to September 30, 2020 through November 23, 2020, the date of financial statement issuance.

As described in Note 2. SIGNIFICANT EVENTS, there has been additional guidance issued by HHS and CMS in October and November 2020. Management is evaluating the impact on the condensed consolidated financial statements.

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## MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL POSITION

This quarterly report includes the condensed consolidated financial statements and analysis for Advocate Aurora Health, Inc., a Delaware nonprofit corporation ("the Parent Corporation"), and its subsidiaries. References to "the System", "we", "our", or "us" in this document are to the Parent Corporation and all of the subsidiaries consolidated with it pursuant to accounting principles generally accepted in the United States of America ("GAAP"). References to the Parent Corporation are references only to the Parent Corporation and should not be read to include any of the Parent Corporation's and subsidiaries.

The financial information should be read together with our condensed consolidated financial statements and related notes included elsewhere in this quarterly report, as well as the audited consolidated financial statements of the System as of and for the year ended December 31, 2019, which is available from the Municipal Securities Rulemaking Board (the MSRB) on its Electronic Municipal Market Access ("EMMA") system, found at <http://emma.msrb.org>. Additional information can be found on the investor relations section of the System's website at <https://www.advocateaurorahealth.org/investor-relations>.

Certain statements included in this quarterly report constitute forward-looking statements that involve risks and uncertainties. Actual results may differ significantly from the results discussed in the forward-looking statements as a result of known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. We do not plan to issue any updates or revisions to those forward-looking statements if or when the expectations, or events, conditions or circumstances on which such statements are based occur.

The information included herein is being provided solely to comply with contractual commitments. This filing does not purport to contain all information that may be material to an investor's decision to buy, sell or hold bonds issued by or for the benefit of the System ("Related Bonds"), and does not constitute or imply any representation that no other information exists that may have a bearing on the financial condition of the System, the security for any Related Bonds or an investor's decision to buy, sell or hold any Related Bonds. This report includes information only as of and for the nine months ended September 30, 2020 and September 30, 2019, and such information should not be relied upon as indicative of future financial performance. The COVID-19 pandemic described herein may adversely affect the System's future financial performance to an extent that could be material.

**ADVOCATE AURORA HEALTH, INC.**  
**KEY FINANCIAL RATIOS**

	<b>Three Months Ended,</b>	
	<b>September 30, 2020</b>	<b>September 30, 2019</b>
<b>Profitability</b>		
Operating margin <sup>(1)</sup>	8.6%	3.7%
Operating cash flow margin <sup>(2)</sup>	13.4%	8.8%
Excess margin <sup>(3)</sup>	13.5%	2.0%
EBIDA margin <sup>(4)</sup>	19.3%	7.1%
	<b>Nine Months Ended,</b>	
	<b>September 30, 2020</b>	<b>September 30, 2019</b>
<b>Profitability</b>		
Operating margin <sup>(1)</sup>	0.5%	4.6%
Operating cash flow margin <sup>(2)</sup>	5.8%	9.8%
Excess margin <sup>(3)</sup>	(4.5)%	10.7%
EBIDA margin <sup>(4)</sup>	1.0%	16.8%
	<b>As of September 30, 2020</b>	<b>As of December 31, 2019</b>
<b>Leverage and Liquidity</b>		
Debt to capitalization <sup>(5)</sup>	24.1%	21.1%
Cash to debt <sup>(6)</sup>	290%	288%
Days cash on hand <sup>(7)</sup>	310	274
Trailing twelve month debt service coverage	5.2x	8.4x

**Profitability**

<sup>(1)</sup> Operating income before nonrecurring expenses/Total revenue

<sup>(2)</sup> (Operating income before nonrecurring expenses + Interest + Depreciation and amortization)/Total revenue

<sup>(3)</sup> Revenue in excess of expenses/(Total revenue + Total nonoperating (loss) income, net)

<sup>(4)</sup> (Revenue in excess of expenses + Interest + Depreciation and amortization)/Total revenue

**Liquidity**

<sup>(5)</sup> (Current portion of long-term debt and commercial paper + Long-term debt subject to short-term financing arrangements + Long-term debt, less current portion)/(Current portion of long-term debt and commercial paper + Long-term debt subject to short-term financing arrangements + Long-term debt, less current portion + Total net assets without donor restrictions)

<sup>(6)</sup> Unrestricted cash and investments/(Current portion of long-term debt and commercial paper + Long-term debt subject to short-term financing arrangements + Long-term debt, less current portion)

<sup>(7)</sup> Unrestricted cash and investments/(Total expenses before nonrecurring expenses - Depreciation and amortization + Nonrecurring expenses (less estimated loss on sale of property)/days in period). The days cash on hand ratio is calculated from expenses for the nine months ended September 30, 2020 and the year ended December 31, 2019.

**ADVOCATE AURORA HEALTH, INC.**  
**KEY FINANCIAL RATIOS**

<b>Trailing twelve-month debt service coverage</b>	<b>As of September 30, 2020</b>
Revenue in excess of expenses- attributable to controlling interest	\$ 985
Adjustments:	
Depreciation and amortization expense	576,139
Interest expense	108,384
Unrealized gain on investments	(98,309)
Unrealized loss on interest rate swap obligation	19,829
Pension settlement loss	119,837
Loss on early extinguishment of debt	33,909
Asset impairment charges	898
Gain on sale of assets not in the ordinary course of business	—
Nonrecurring expenses	85,708
Total income available for debt service	847,380
 Debt service requirements	 164,278
Historical debt service coverage ratio	5.2

This ratio is being presented for information purposes only and is not indicative of future results. This ratio is calculated in the same manner as that presented in the Management, Discussion and Analysis of the condensed consolidated financial statements as of and for the year ended December 31, 2019.



**ADVOCATE AURORA HEALTH, INC.**  
**HISTORICAL UTILIZATION**

	<b>Three Months Ended September 30, 2020</b>	<b>Three Months Ended September 30, 2019</b>	<b>Change</b>	<b>% Change</b>	<b>Modified Change<sup>(2)</sup></b>	<b>Modified % Change<sup>(2)</sup></b>
Discharges	61,615	67,420	(5,805)	(8.6)%	(3,634)	(5.6)%
Observation Cases	22,556	27,441	(4,885)	(17.8)%	(4,135)	(15.5)%
Hospital Outpatient Visits	942,504	1,141,534	(199,030)	(17.4)%	(154,679)	(14.1)%
Physician Visits	2,279,113	2,479,786	(200,673)	(8.1)%		
Home Care Visits	195,098	192,622	2,476	1.3 %		
Capitated Member Lives <sup>(1)</sup>	251,019	285,586	(34,567)	(12.1)%		
	<b>Nine Months Ended September 30, 2020</b>	<b>Nine Months Ended September 30, 2019</b>	<b>Change</b>	<b>% Change</b>	<b>Modified Change<sup>(3)</sup></b>	<b>Modified % Change<sup>(3)</sup></b>
Discharges	184,023	202,455	(18,432)	(9.1)%	(16,967)	(8.5)%
Observation Cases	63,703	79,414	(15,711)	(19.8)%	(15,336)	(19.5)%
Outpatient Visits	2,614,594	3,285,203	(670,609)	(20.4)%	(667,118)	(20.6)%
Physician Visits	6,366,497	7,225,898	(859,401)	(11.9)%		
Home Care Visits	545,601	586,710	(41,109)	(7.0)%		

<sup>(1)</sup> As of the date set forth in the column header

<sup>(2)</sup> For comparison purposes the impact of Central Illinois for the three month period June through September 2019 is excluded as Central Illinois was disposed of in 2020 and therefore there are no comparable amounts for the three months ended September 30, 2020. See discussion of this transaction within Note 2. SIGNIFICANT EVENTS of the Condensed Consolidated Financial Statements.

<sup>(3)</sup> For comparison purposes the impact of Central Illinois for the three month period of June through September 2019 is excluded as Central Illinois was disposed of in 2020 and therefore there are no comparable amounts for the three months ended September 30, 2020 and the impact of the three month period ended March 31, 2020 for Bay Area Medical Center are excluded as Bay Area was acquired on April 1, 2019 and therefore there are no comparable amounts in 2019. See discussion of this transaction within NOTE 17. ACQUISITION OF BAY AREA MEDICAL CENTER of the Condensed Consolidated Financial Statements.

## **MANAGEMENT DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS**

**(in thousands)**

The management discussion and analysis section refers to the condensed consolidated statements of operations.

### Results of Operations – Nine Months Ended September 30, 2020 Compared to Nine Months Ended September 30, 2019

Operating income before nonrecurring expenses was \$49,763 for the nine months ended September 30, 2020, resulting in an operating margin of 0.5%, compared to operating income before nonrecurring expenses of \$434,133 for the nine months ended September 30, 2019, for an operating margin of 4.6%. This represented a period-over-period decrease of \$384,370. If the impact of both the Central Illinois disposal and BAMC acquisition were excluded, the period-over-period decrease would increase by \$10,593 to \$394,963.

In response to the COVID-19 pandemic, on March 17, 2020, the System began postponing or canceling elective procedures to comply with public health protocols and open surge capacity. The public also curtailed visits to physicians, clinics and emergency rooms for fear of contracting COVID-19. These actions have served to decrease revenues from non-COVID-19 patients while driving up costs to prepare for and care for COVID-19 patients. While operating results have improved due to the restart of elective procedures and clinic visits, the System continues to be impacted by COVID-19. For the nine months ended September 30, 2020, the System has recognized \$596,000 in the condensed consolidated financial statements in other revenue related to the U.S. Department of Health and Human Services grants distributed from the Provider Relief Fund established under the Coronavirus Aid, Relief and Economic Security Act (Phase 3), ("CARES Act"). These grant funds were provided as partial coverage for lost revenues and expenses incurred by the System attributed to COVID-19.

Total revenue for the nine months ended September 30, 2020 was \$9,468,048, which was \$26,253 (0.3%) higher than the comparative period of 2019. If the impact of the Central Illinois disposal and the BAMC acquisition were excluded, the increase in total revenue would be \$65,205 (0.7%).

Patient service revenue decreased \$538,947 (6.9%), in the nine months ended September 30, 2020 compared to the same period in the prior year. If the impact of Central Illinois disposal and the BAMC acquisition were excluded, the decrease in patient service revenue would be reduced by \$31,939 to \$507,088 (6.5%). The decrease was primarily due to a decrease in hospital outpatient visits and physician clinic visits over the comparative period and an increase in bad debt as a result of the COVID-19 pandemic.

Capitation revenue decreased \$106,670 (11.2%) in the nine months ended September 30, 2020, compared to the same period in the prior year due to a decrease in capitated lives of 12.1%. The decrease in membership was driven by less demand for exchange plan products as a result of higher employment rates prior to the COVID-19 pandemic and the lack of the federal mandate requiring insurance coverage.

Other operating revenue of \$1,301,404 increased \$671,870 (106.7%), of this amount \$595,605 related to the HHS Provider Relief grants. The remaining increase of \$75,870 (12.1%) was driven by increased pharmacy and shared savings revenue.

Total expenses (excluding nonrecurring expenses) for the nine months ended September 30, 2020 was \$9,418,285, which was \$410,623 (4.6%) higher than the comparative period of 2019. If the impact of the Central Illinois disposal and the BAMC acquisition were excluded, the increase in total expenses would be \$455,372 (5.1%).

Salaries, wages and benefits expenses increased \$342,738 (6.6%). If the impact of the Central Illinois disposal and the BAMC acquisition were excluded, the increase in salaries and wages would be \$368,555 (7.2%) due to an increase in full-time equivalent employees ("FTE's") of 1.4% and the large increases in employee compensation to respond to the COVID-19 pandemic and pay and benefit continuation programs for furloughed employees. Additionally, an increase in benefit expense was driven by higher claim experience associated with employee health plans.

Supplies, purchased services and other expenses increased \$79,517 (2.7%). If the impact of the Central Illinois disposal and the BAMC acquisition were excluded, the increase would be \$89,594 (3.1%). The increase is primarily due to the higher acuity of COVID-19 patients, costs of personal protective equipment and increased drug costs, including specialty drugs and medical and patient supply costs.

Nonrecurring expenses were \$76,689 and \$107,781 for the nine months ended September 30, 2020 and September 30, 2019, respectively. Included in the nine month period ended September 30, 2020 is the \$14,585 loss on the divestiture of operations in Central Illinois as described in NOTE 2. SIGNIFICANT EVENTS of the condensed consolidated financial statements. Nonrecurring expenses, in addition to the loss on divestiture, consist of costs incurred in connection with the implementation of an electronic medical records and billing system, the implementation of an enterprise resource planning system and, as part of the initiative to reduce operating expenses, an early retirement incentive program and position restructuring.

The nonoperating loss of \$(378,696) for the nine months ended September 30, 2020 compares unfavorably to the nonoperating income of \$764,994 for the nine months ended September 30, 2019 primarily due to investment income (loss), net which decreased \$903,850 over the comparative period. See disclosure of the composition of investment income (loss), net within Note 5. INVESTMENTS of the condensed consolidated financial statements. The decrease is due to a deterioration in the financial markets over the comparative period resulting from the COVID-19 pandemic. The change in fair value of interest rate swaps is attributable to the change (a decline) in interest rates. The pension settlement loss of \$119,658 is related to the transfer of pension benefit obligations in September 2020, see disclosure within Note 12. RETIREMENT PLANS of the condensed consolidated financial statements. Other nonoperating income (loss), of \$(22,664) compared unfavorably to the other nonoperating income (loss) of \$86,524 primarily due to the BAMC gain of \$81,736 recorded during the nine month period ended September 30, 2019.

Overall, the System reported revenue (less than) in excess of expenses - attributable to controlling interest of \$(434,900) for the nine months ended September 30, 2020 compared to \$1,050,062 for the nine months ended September 30, 2019 due primarily to decreased investment yields and operating loss resulting from the COVID-19 pandemic.

## **Liquidity**

The System holds substantially all its' investments in a single investment portfolio. The investments in this portfolio are managed by external investment professionals under the guidelines set out in the investment policy statement adopted by the System's Board.

This policy includes the target allocations for the System investment program. The System's investment program's target asset allocation, excluding cash and cash equivalents maintained for operating purposes, provides for a commitment to equity securities (30%), fixed income investments (20%), and select alternative investment classes (50%). Limitations are placed on investment managers as to the overall amount that can be invested in one issuer (except for U.S. government obligations and its agencies) or economic sector. See disclosure of the composition of the System's investment assets within NOTE 6. FAIR VALUE.

Investment income (loss) (including both realized and unrealized gains on investments) significantly impacts the System's financial results. Market fluctuations have affected and will likely continue to materially affect the value of those investments and those fluctuations may be and historically have been material. Reduction in investment income, or realized and unrealized losses, and the market value of its investments may have a negative impact on the System's financial condition, including its ability to provide its own liquidity for variable rate debt or to fund capital expenditures from cash and investments.

The System's financing strategy is to ensure liquidity and access to capital markets, to maintain a balanced spectrum of debt maturities and to manage our net exposure to floating interest rate volatility. Within these parameters, we seek to minimize our borrowing costs. The ability to access the long-term debt and commercial paper markets helps provide the System with sources of liquidity. Management is authorized to issue commercial paper and/or have lines of credit in place up to a combined maximum of \$2,500,000 (with a sublimit of \$1,000,000 on commercial paper) at any given time.

### **Days Cash on Hand**

Days cash on hand was 310 as of September 30, 2020 compared to 274 as of December 31, 2019. The increase in days cash on hand is primarily due to the Series 2020A issuance, receipt of Medicare accelerated and advance payments and deferred remittance of employer portion of the Social Security tax portion of FICA taxes.

### **Indebtedness**

Master Indenture Obligations: Substantially all of the System's outstanding bonds and certain other obligations to lenders, banks and swap counterparties are all secured by Obligations issued under the Second Amended and Restated Master Trust Indenture dated as of August 1, 2018, with the Members of the Obligated Group and U.S. Bank National Association, as master trustee (the "System Master Indenture").

In connection with the BAMC acquisition, the System assumed \$81,465 of tax-exempt bonds, which were redeemed with the proceeds from the issuance of commercial paper in the amount of \$82,000.

On November 14, 2019, the System issued \$357,970 of 30-year Taxable Bonds to refinance certain tax-exempt bonds in the aggregate principal amount of \$323,325 and to pay certain expenses incurred in connection with their issuance.

On May 5, 2020, the System issued \$700,000 of Taxable Bonds for general corporate purposes, to refinance certain tax-exempt bonds in the aggregate principal amount of \$78,750, to refinance commercial paper in the amount of \$82,000, and to pay certain expenses incurred in connection with their issuance.

Under the terms of the bond indentures and other arrangements, various amounts are to be on deposit with trustees, and certain specified payments are required for bond redemption and interest payments. The System Master Indenture and other debt agreements, including bank credit agreements, also place restrictions on the System to maintain certain financial ratios. Each of the bank agreements requires various reporting, operating and financial covenants to be maintained. These covenants may be waived, modified or amended by the related bank in its sole discretion and without notice to or consent by any bond trustee, the Master Trustee or the holders of any outstanding bonds. Violation of any such covenants may result in an Event of Default under the System Master Indenture, which could result in acceleration of all Obligations issued under the System Master Indenture.

The System's total long-term debt and commercial paper was as follows:

	September 30, 2020	December 31, 2019
Tax-exempt bonds	\$ 1,416,672	\$ 1,514,551
Taxable bonds	1,760,368	1,064,331
Financing arrangements	216,479	235,249
Taxable term loan	97,864	114,868
Commercial paper	50,000	132,000
Total long-term debt	<u>\$ 3,541,383</u>	<u>\$ 3,060,999</u>

**Standby Bond Purchase Agreements ("SBPA"):** The System is a party to three SBPAs with two banks to provide liquidity support for the three subseries of the Series 2008C Bonds in the event of a failed remarketing of any such Series 2008C Bonds. The termination dates of the SBPAs are as follows:

Subseries	Par	Expiration
2008C-1	\$ 129,500	1/15/2024
2008C-2B	58,200	9/30/2025
2008C-3A	87,700	9/27/2024
Total	<u>\$ 275,400</u>	

In the event any bonds are not remarketed within one year from the date they are purchased by a bank pursuant to an SBPA ("Bank Bonds"), the System has agreed to cause such Bank Bonds to be redeemed pursuant to the related bond indenture such that the unpaid principal balance of all outstanding Bank Bonds shall amortize in approximately equal quarterly installments, with the first installment commencing on the date that is one year and one day after the date on which such Series 2008C Bond became a Bank Bond, the final installment payable on the date that is five years from the date on which such Series 2008C Bond became a Bank Bond (or, with respect to any Series 2008C-1 Bond that is a Bank Bond, if earlier, the date that is one year and one day following the then current Stated Expiration Date which is January 15, 2024). At September 30, 2020, there were no Bank Bonds outstanding.

**Covenant Agreements ("CAs"):** The System is party to CAs with a bank, related to the Series 2011C Bonds and Series 2011D Bonds issued in September 2011 and purchased by the bank. The Series 2011C Bonds and Series 2011D Bonds currently bear interest at an indexed rate until September 3, 2024. At the end of their initial periods, the Series 2011C Bonds and the Series 2011D Bonds will be subject to mandatory tender, unless waived by the holders thereof, and the System presently anticipates that the Series 2011C Bonds and Series 2011D Bonds will be remarketed to new holders in one of the interest rate modes available under the related bond indenture. In the event the Series 2011C Bonds or the Series 2011D Bonds are not remarketed on their respective mandatory tender dates, then, as long as no default or event of default (as defined in the CAs) has occurred and is continuing, the Series 2011C Bonds or Series 2011D Bonds, as applicable, may either be repaid over a three-year period or remarketed during that time.

**Windows Variable Rate Bonds:** The System's Series 2011B Bonds bear interest at Windows Interest Rates (the "Windows Variable Rate Bonds") and are subject to optional and mandatory tender for purchase. The Windows Variable Rate Bonds are not supported by any external dedicated liquidity facility. Holders of Windows Variable Rate Bonds have a right to optionally tender their Bonds for purchase. If the tendered Windows Variable Rate Bonds are not successfully remarketed within the 30-day period that follows the date that notice of such optional tender is received by the Remarketing Agent (the "Remarketing Window"), then all Windows Variable Rate Bonds are required to be purchased on the day that is 210 days after notice of such optional tender is received by the Remarketing Agent (the "Windows Mandatory Tender Date"). The period from the end of the Remarketing Window until the Windows Mandatory Tender Date (initially, 180 days) is referred to as the Funding Window. During the Funding Window, the System expects that it would analyze the then current market conditions,

availability and relative cost of any refinancing or restructuring alternatives for those Windows Variable Rate Bonds that are required to be purchased on the Windows Mandatory Tender Date (including, without limitation, conversion of those bonds to another interest mode or the refinancing or repayment of those bonds). The Windows Variable Rate Bonds are classified as current liabilities at September 30, 2020 and December 31, 2019 in the condensed consolidated balance sheets because these bonds may be subject to tender on a date that was within one year of the balance sheet date.

Long-term Rate Bonds: The Series 2018B-1, 2018B-2, Series 2018B-3 and Series 2018B-4 Bonds ("the Long-Term Rate Bonds") bear interest at long-term rates for a particular interest rate period and are subject to mandatory tender at the end of each particular interest rate period.

The following table summarizes the next scheduled mandatory tender dates for the Long-Term Rate Bonds as of September 30, 2020. In the event these Long-Term Rate Bonds are not remarketed upon mandatory tender at the end of their current interest rate period, management anticipates utilizing marketable unrestricted investments, commercial paper issuance and/or available lines of credit to meet the purchase obligations.

Subseries	Par	Expiration
Series 2018B-1	46,690	1/26/2022
Series 2018B-2	46,310	1/25/2023
Series 2018B-3	48,560	1/31/2024
Series 2018B-4	49,420	1/29/2025
Total	<u>\$ 190,980</u>	

The Series 2008A-1 Bonds were subject to mandatory tender on January 15, 2020 (the "Jan 2020 Mandatory Tender Date"). The Series 2008A-1 Bonds were classified as current liabilities as of December 31, 2019 in the condensed consolidated balance sheets as these bonds were subject to mandatory tender on a date that was within one year of the balance sheet date. While \$42,045 of the Series 2008A-1 Bonds were outstanding on the Jan 2020 Mandatory Tender Date, only \$36,455 of the Series 2008A-1 Bonds were remarketed. The reduction in the principal amount reflects the application of the premium paid on the Series 2008A-1 Bonds upon their remarketing, together with other funds, to the retirement of \$5,590 of the Series 2008A-1 Bonds on the Jan 2020 Mandatory Tender Date. The Series 2008A-1 Bonds will next be subject to mandatory tender on November 1, 2030, which is also the maturity date for the Series 2008A-1 Bonds.

The Series 2008A-2 Bonds were subject to mandatory tender on February 12, 2020 (the "Feb 2020 Mandatory Tender Date"). The Series 2008A-2 Bonds were classified as current liabilities as of December 31, 2019 in the condensed consolidated balance sheets as these bonds were subject to mandatory tender on a date that was within one year of the balance sheet date. While \$35,490 of the Series 2008A-2 Bonds were outstanding on the Feb 2020 Mandatory Tender Date, only \$30,820 of the Series 2008A-2 Bonds were remarketed. The reduction in the principal amount reflects the application of the premium paid on the Series 2008A-2 Bonds upon their remarketing, together with other funds, to the retirement of \$4,670 of the Series 2008A-2 Bonds on the Feb 2020 Mandatory Tender Date. The Series 2008A-2 Bonds will next be subject to mandatory tender on November 1, 2030, which is also the maturity date for the Series 2008A-2 Bonds.

The Series 2008A-3 Bonds were subject to mandatory tender on May 1, 2019 (the "2019 Mandatory Tender Date"). While \$42,795 of the Series 2008A-3 Bonds were outstanding on the 2019 Mandatory Tender Date, only \$36,535 of the Series 2008A-3 Bonds were remarketed. The reduction in the principal amount reflects the application of the premium paid on the Series 2008A-3 Bonds upon their remarketing, together with other funds, to the retirement of \$6,260 of the Series 2008A-3 Bonds on the 2019 Mandatory Tender Date. The Series 2008A-3 Bonds will next be subject to mandatory tender on November 1, 2030, which is also the maturity date for the Series 2008A-3 Bonds.

**Indexed Floating Rate Bonds:** The Series 2018C-1 Bonds, Series 2018C-2 Bonds, Series 2018C-3 Bonds and Series 2018C-4 Bonds (collectively the "2018C Bonds") bear interest at an indexed rate. At the end of their respective initial index rate periods, the Series 2018C Bonds will be subject to mandatory tender. The Series 2018C-1 Bonds were classified as current liabilities as of September 30, 2020 in the condensed consolidated balance sheets as these bonds were subject to mandatory tender on a date that was within one year of the balance sheet date. The System presently anticipates that the Series 2018C Bonds will be remarketed to new holders in one of the interest rate modes available under the related bond indentures. The following table summarizes the next scheduled mandatory tender dates for these bonds.

<b>Subseries</b>	<b>Principal Amount</b>	<b>Next Mandatory Tender date</b>
Series 2018C-1	\$ 50,000	7/28/2021
Series 2018C-2	50,000	7/27/2022
Series 2018C-3	49,065	7/26/2023
Series 2018C-4	50,350	7/31/2024
Total	<u>\$ 199,415</u>	

**Taxable Term Note:** The System is party to a taxable term loan agreement with a bank, relating to a \$97,864 term loan, the proceeds of which were used to defease a portion of the Series 2010 Bonds. Absent an agreement between the System and the bank to extend the final maturity, the taxable term loan matures on September 27, 2024.

**Commercial Paper:** In order to enhance the System's liquidity, Management has the authority to issue up to \$1,000,000 from time to time under the System's commercial paper program. On March 5, 2019, the System issued commercial paper in the amount of \$50,000. The proceeds of the commercial paper were used to redeem the Series 2008C-2A bonds of \$49,230 plus accrued interest and certain costs related to the issuance of the commercial paper. The remaining proceeds were used for general corporate purposes.

On November 19, 2019, the System issued commercial paper in the amount of \$82,000. The proceeds of the commercial paper were used to redeem certain bonds previously issued for BAMC in the aggregate principal amount of \$81,465 plus accrued interest. The remaining proceeds were used for general corporate purposes. In May 2020, a portion of the proceeds of the Series 2020A Bonds were used by the System to retire \$82,000 of commercial paper.

As of the date of this report, the System has the authority to issue \$950,000 of additional commercial paper.

**Lines of Credit:** At September 30, 2020, the System had lines of credit agreements with banks totaling \$1,350,000. These agreements expire as follows: \$1,150,000 in April 2021, \$100,000 in August 2021 and \$100,000 in December 2022. At September 30, 2020, the System had a \$100,000 line of credit, under which letters of credit can also be issued. At September 30, 2020, letters issued under the line of credit totaling \$58,326 were outstanding. At September 30, 2020, there were no outstanding draws on the line of credit or letters of credit. Each line of credit is secured by a separate Obligation issued under the System Master Indenture.

Under regulatory rules of the State of Illinois, Advocate is required to post a letter of credit or surety bond with a State Agency, Advocate held a surety bond in the amount of \$16,425. No amounts were drawn on this surety bond at September 30, 2020.

**Other Indebtedness:** At September 30, 2020, the System had various finance lease arrangements totaling \$216,479 classified as long-term debt. These arrangements, which relate to various administrative and medical support buildings, had initial lease terms of 15 to 25 years.

Interest Rate Swaps: The System has multiple floating-to-fixed interest rate swap arrangements with respect to the Series 2008C Bonds (collectively, the Series 2008C Swaps) pursuant to ISDA Master Agreements. Pursuant to the Series 2008C Swaps, Wells Fargo Bank, National Association ("Wells Fargo") and PNC Bank, National Association ("PNC") pay the System the sum of a percentage of the one-month London Interbank Offered Rate ("LIBOR") plus a spread, and the System pays Wells Fargo and PNC amounts based on a fixed rate (approximately 3.605%). All Wells Fargo, PNC and the System payments are made on a same day net payment basis with reference to a notional amount that declines over the term of the Series 2008C Swaps. Unless terminated earlier in accordance with their terms, the Series 2008C Swaps' scheduled termination date is November 1, 2038. Under certain circumstances; however, the Series 2008C Swaps are subject to termination prior to the scheduled termination date.

In connection with the BAMC acquisition, the System acquired an interest rate swap. BAMC had entered into a floating-to-fixed interest rate swap agreement ("Bay Area Swap") pursuant to an ISDA Master Agreement. Piper Jaffray Financial Products Inc. ("Piper Jaffray") pays BAMC a percentage of the one-month LIBOR and BAMC pays Piper Jaffray amounts based on a fixed rate (approximately 3.314%) based on the notional amount which declines over the term of the Bay Area Swap. Unless terminated earlier in accordance with their terms, the Bay Area Swap's scheduled termination date is February 1, 2038. Under certain circumstances, the Bay Area Swap is subject to termination prior to the scheduled termination date.

See Note 6. FAIR VALUE and Note 11. INTEREST RATE SWAP PROGRAM for discussion of the fair value and a description of the accounting treatment of the System's interest rate swap arrangements.

Securities Lending: As part of the management of the investment portfolio, the System has entered into an arrangement whereby securities owned by the System are loaned, primarily to brokers and investment banks. The loans are arranged through a bank. Borrowers are required to post collateral in the form of cash or highly rated securities for securities borrowed equal to no less than 102% of the value of the security loaned on a daily basis. The bank is responsible for reviewing the credit-worthiness of the borrowers. The System has also entered into an arrangement whereby the bank is responsible for the risk of borrower bankruptcy and default. At September 30, 2020 and December 31, 2019, the System loaned approximately \$16,500 and \$17,672, respectively in securities and accepted collateral for these loans in the amount of \$16,971 and \$18,284, respectively which represented cash and government securities. The collateral received under the securities lending program has been reflected as a current asset and a current obligation payable in the condensed consolidated balance sheets presented. The balance of securities on loan and accepted collateral fluctuates daily.

## **Capital Expenditures**

For the nine months ended September 30, 2020, capital expenditures of the System were \$515,992; at September 30, 2020 the System had \$377,294 of construction-in-progress. The amounts of construction-in-progress at September 30, 2020 relate to various projects to improve existing facilities and expand access to health care in the markets served.

The System is building a hospital and medical office building on a site along the I-94 corridor in Mount Pleasant, Wisconsin. The System expects the hospital, medical office building and ancillary buildings to cost approximately \$230,000, with construction estimated to be completed in 2021 and opened for patients in February 2022. Also, the System is building a medical campus, replacing an existing campus, in Sheboygan, Wisconsin. The cost is approximated at \$325,000 with an expected completion date in 2022. Additionally, in October 2018, the System broke ground on an ambulatory surgery center and medical office building project in the Kenosha/Pleasant Prairie, Wisconsin area. The medical building was completed and opened for patients in June 2020 with the ambulatory surgery center opened for patients in November 2020. Currently, management expects to fund capital commitments and expenditures with cash generated from operations and investment income,



as well as from existing cash and investment balances, but could elect to fund portions with the proceeds of additional indebtedness in light of the COVID-19 crisis.

Management continues to evaluate planned capital projects and routine capital expenditures with a focus on liquidity needs, operating margin considerations and alignment with the strategic plan.

## **LEGAL AND REGULATORY COMPLIANCE**

The System operates in a highly litigious industry. As a result, various lawsuits, claims and proceedings have been instituted or asserted against it from time to time. The System has knowledge of certain pending suits against certain of its entities that have arisen in the ordinary course of business. In the opinion of management, the System maintains adequate insurance and/or other financial reserves to cover the estimated potential liability for damages in these cases, or, to the extent such liability is uninsured, adverse decisions will not have a material adverse effect on the financial position or operations of the System.

As a health care provider, the System entities are subject to extensive and frequently changing federal, state and local laws and regulations governing various aspects of our business. In particular, the System entities provide a broad range of services, many of which are regulated by different government agencies, subject to differing regulatory schemes and subject to contractual reviews and program audits in the normal course of business. Many operations that the System entities undertake are subject to significant governmental certification and licensing regulations, as well as federal and state laws.

The System, like all major health care systems, periodically may be subject to investigations or audits by federal, state and local agencies involving compliance with a variety of laws and regulations. These investigations seek to determine compliance with, among other things, laws and regulations relating to Medicare and Medicaid reimbursement, including billing practices for certain services. Violation of such laws could result in substantial monetary fines, civil and/or criminal penalties and exclusion from participation in Medicare, Medicaid or similar programs.

On or about January 1, 2020, several of the System's employee email credentials were accessed through an email phishing campaign. A description of this incident is described within the "REGULATION of the HEALTHCARE INDUSTRY " section in the Offering Memorandum dated April 28, 2020, relating to the Series 2020A Bonds. The Offering Memorandum can be accessed at <http://munios.com>.

## **Compliance and Internal Audit Programs**

The System's Compliance and Integrity Program ("Program") is overseen by the System Chief Compliance Officer. The System Chief Compliance Officer reports to the System Chief Integration Officer, who is a direct report to the CEO, with reporting accountability to the Audit and Compliance Committee of the System Board of Directors. The Program is modeled after the seven essential elements of an effective compliance program, as set forth in the U.S. Health and Human Services, Office of Inspector General Compliance Program Guidance and further interpreted by the Federal Sentencing Guidelines and the U.S. Department of Justice Guidelines for the Federal Prosecution of Corporations. The Program includes mandatory annual education of all employees regarding specific legal and regulatory requirements applicable to health care organizations, including requirements related to patient confidentiality, information privacy, information systems security, conflicts of interest, licensure and certification, federal fraud and abuse laws, billing, coding and documentation, civil rights and non-retaliation. The Program is based on a Code of Conduct and includes an anonymous hotline available to report violations or seek guidance on compliance issues.

The System also has an internal audit department responsible for providing independent and objective assurance and consulting services designed to add value and help the System accomplish its objectives by bringing a systematic, disciplined approach to evaluate the effectiveness of risk management, control and governance

processes. The System Audit Officer reports functionally to the Audit and Compliance Committee of the Board of Directors and administratively to the Chief Financial Officer. The internal audit department carries out an annual audit program that assesses the System's design and operation of internal controls to achieve efficient and effective operations, accurate and reliable financial reporting, compliance with policies, laws and regulations and the proper safeguarding of assets.

## **BOND RATINGS**

In April 2020 in connection with the issuance of the Series 2020A Bonds, ratings were obtained for all of the System's debt. Fitch assigned a rating of AA (stable outlook), S&P assigned a rating of AA (stable outlook) and Moody's assigned a rating of Aa3 (positive outlook).

The ratings above reflect only the view of the rating organization providing the same, and an explanation of the significance of such ratings may be obtained only from the rating agency furnishing the same. There is no assurance that such ratings will continue for any given period of time or that they will not be revised downward or withdrawn entirely by such rating agency if, in its judgment, circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of System's outstanding bonds. A securities rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time.

Additional information on the System's bond ratings can be obtained from the Investor Relations section on <https://www.advocateaurorahealth.org/investor-relations>.

## **MANAGEMENT**

Key members of the management of the System are described within the "GOVERNANCE AND MANAGEMENT" section in Appendix A to the Offering Memorandum dated April 28, 2020, relating to the Series 2020A Bonds. The Offering Memorandum can be accessed at <http://munios.com>. Management has recently commenced a search for a new Chief Strategy Officer. Upon a new appointment Scott Powder, the current incumbent, will be assigned to focus exclusively on the Whole Person Health portion of the System's strategic plan.

## **SYSTEM STRATEGY**

The System maintains a strategic plan and is well positioned to carry out its purpose: to help people live well. The plan calls for transformation of the System's core business of health care delivery while simultaneously building the System's future as a consumer health company. The plan has three major focus areas: Transform the Core, Consumer-First and Whole Person Health. Transform the Core includes strategies to achieve breakthrough performance in safety, health outcomes, growth and affordability. Consumer-First includes strategies to provide a seamless and connected consumer experience. Whole Person Health includes strategies to develop new care models and new consumer-facing businesses targeted to individualized health and wellness needs.

The System will continue to evaluate potential affiliations, disaffiliations, joint ventures and other strategic relationships that it believes will be advantageous.

## **CYBERSECURITY**

Healthcare providers and insurers are highly dependent upon integrated electronic medical record and other information technology systems to deliver high quality, coordinated and cost-effective healthcare. These systems necessarily hold large quantities of highly sensitive protected health information that is highly valued on the black market for such information. As a result, the electronic systems and networks of healthcare providers and insurers are considered likely targets for cyberattacks and other potential breaches of their systems. In addition to regulatory fines and penalties, the healthcare entities subject to the breaches may be liable for the costs of remediating the breaches, damages to individuals (or classes) whose information has

been breached, reputational damage and business loss and damage to the information technology infrastructure. The System has taken, and continues to take, measures to protect its information technology system against such cyberattacks, but there can be no assurance that the System will not experience a significant breach. If such a breach occurs, the financial consequences of such a breach could have a materially adverse impact on the System.

As the System's investment in information technology continues to increase, cybersecurity continues to be a top priority. The System has developed a cyber security program and continues to implement tools, processes and policies to secure its technology infrastructure and protect its data assets. The cyber security program is dynamic in nature with all tenets under constant review and modification to protect against continually emerging threats and to ensure regulatory compliance.

## **INDUSTRY RISKS**

For a description of industry risks, see the "BONDHOLDERS' RISKS" section in the Offering Memorandum dated April 28, 2020, relating to the Series 2020A Bonds. The Offering Memorandum can be accessed at <http://munios.com>.

As described in the BONDHOLDERS' RISKS section in the Offering Memorandum, the System is aware of certain additional risks regarding the spread of COVID-19, a strain of coronavirus. On March 11, 2020, the World Health Organization declared COVID-19 a pandemic, and on March 13, 2020, President Trump declared a national emergency. The federal government and a large number of state governments, including Illinois and Wisconsin, have imposed strict measures to curtail certain aspects of public life in an effort to contain the spread of COVID-19.

An outbreak of an infectious disease, including any growth in the magnitude or severity of COVID-19 cases in the System's service areas, could result in an abnormally high demand for health care services, potentially inundating hospitals with patients in need of intensive care services and the treatment of a highly contagious disease at one of the System's facilities could also result in a temporary shutdown of facilities or diversion of patients or staffing shortages. Additionally, elective procedures may be deferred, resulting in reduced patient volumes and operating revenues at the System's facilities. Further, the changing global economic conditions or potential global health concerns such as the COVID-19 may also affect the System's partners, suppliers, distributors and payors, potentially disrupting or delaying the System's supply chain and delaying reimbursement by governmental or private payors.

The spread of COVID-19 has altered the behavior of businesses and people in a manner that is having negative effects, including significant growth in unemployment and underemployment related to business curtailment and closures, on global and local economies. In response to COVID-19 concerns, which resulted in the deferral or cancellation of most elective procedures occurring within the System's facilities from mid-March to mid-May when reactivation began, the System's patient service revenue from March to September was approximately \$700,000 or 20% lower than the comparable period of 2019. The System has also incurred cost of approximately \$200,000 through September 30, 2020 associated with the COVID-19 pandemic primarily in the form of increased salaries and wages related to pay programs implemented to compensate team members assigned to COVID-19 hotspots and other continuity related pay and other preparation related costs. The System continues to evaluate its pay programs and other costs and will adjust as the System's needs continue to evolve. It is not possible to predict the costs associated with the potential treatment of an infectious disease outbreak by the System's health care operations or preparation for such treatment.

In addition to the direct impact to the health care industry, investment markets in the United States and globally saw a significant decline in value in March attributed to COVID-19 concerns. The investment markets started to recover in April, but continued spread of COVID-19 or any other similar outbreaks could result in another significant decline in value.

The continued spread of COVID-19 or any other similar outbreaks in the future may materially adversely impact the System's financial condition and results of operations, as well as national and local economies.

In response to this crisis, the Coronavirus Aid, Relief and Economic Security Act ("CARES Act") stimulus package was passed by Congress and signed into law by President Trump. The CARES Act is designed to provide \$2,200,000,000 in emergency assistance to individuals, and various businesses, including hospitals and other health care providers. Under the CARES Act legislation, the Department of Health and Human Services ("HHS") was authorized to distribute \$100,000,000 in relief funds to hospitals and healthcare providers on the front lines of the COVID-19 pandemic. On April 10, 2020, HHS began in different tranches distributing the first \$50,000,000 of \$100,000,000 from a Provider Relief Fund ("PRF") established under the CARES Act in the form of grants to providers. Through September 30, 2020, the System has received and recognized \$596,000 in grants distributed in various general or targeted tranches from the PRF. Payments from the PRF are intended to cover patient care lost revenues and qualified expenses, net of other reimbursed sources, attributed to COVID-19 and are not required to be repaid provided the recipient attests to and complies with the terms and conditions of the PRF grant funds. Management will continue to monitor compliance with the terms and conditions of the CARES Act grant funds and the impact of the pandemic on the System's revenues and expenses. If the System is unable to attest to or comply with current or future terms and conditions, the ability to retain some or all of the distribution received may be impacted.

The CARES Act also permits employers to defer the employer portion of Social Security taxes of the FICA payroll tax. Employers are required to remit one-half of the amount deferred by December 31, 2021 and the remaining half by December 31, 2022. Through September 30, 2020 the System deferred \$153,000, which is included in other noncurrent liabilities within the condensed consolidated balance sheets.

In addition to the CARES Act grants, the System received approximately \$773,000 from the Centers for Medicare and Medicaid ("CMS") as an advance payment for Medicare services. The funds were provided through the expansion of the Accelerated and Advance Payment Program to ensure providers and suppliers have the resources needed to combat the COVID-19 pandemic. The advances will be recouped by withholding future Medicare fee-for-service payments for claims until such time as the full accelerated payment has been recouped. As of September 30, 2020, the terms and conditions in effect required any outstanding balance of the advance payments remaining after 12 months from the date of receipt must be paid or subject to interest. As of October 1, 2020, the terms and conditions have been revised whereby the recoupment period has been extended to twenty-nine months after the original receipt of the advance, with recoupments beginning in April 2021. Subsequent to twenty-nine month recoupment period any unpaid remaining balance is subject to an interest charge of 4 percent per annum.

The System has benefited through September 30, 2020 by \$29,142 from the suspension of Medicare sequestration and the 20% add-on to the DRG payment of inpatients admitted with COVID-19 during the emergency period imposed under the CARES Act. Further, the System received through September 30, 2020 approximately \$9,000 in additional Illinois Medicaid Hospital Assessment Program and Wisconsin disproportionate share hospital payments.

The System does anticipate as a result of the significant increase in unemployment and underemployment caused by business curtailment and closures, collectability on the patient responsibility portions of its non-COVID-19 related accounts receivable will be negatively impacted. As a result, the System increased its estimate for uncollectible accounts by approximately \$40,000.

The System has reactivated all aspects of its health care operations. The success of such reactivation is subject to many factors external to the System including potential new government mandated prohibitions of non-essential healthcare procedures, the willingness of patients to resume preventive and elective care, availability of personal protection equipment and other supplies and drugs, changes in clinical care and patient and caregiver safety protocols and processes required by the Centers for Disease Control and Prevention, the Occupational Health and Safety Administration, states' departments of public health and other government bodies. Due to the resurgence of COVID-19 in the markets the System serves, the System announced on

November 16, 2020 that it will begin scaling back certain elective inpatient procedure by 50%, or more depending on market dynamics, in order to mitigate potential staffing and capacity challenges. Future changes will be dictated on resource and COVID-19 surge levels.

Although the System has activated plans to address the COVID-19 threat and operates pursuant to infectious disease protocols, the potential impact of a pandemic, epidemic or outbreak of an infectious disease with respect to the System's service areas or facilities is difficult to predict and could adversely impact the business, financial condition or results of operations, and, accordingly, may materially adversely impact the financial condition of the System.

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